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Preface

It gives us immense pleasure, to present this study material before the distance learning students of B. Com. Part-III. The students who are deprived from taking admission in the colleges due to some personal or social reasons may get the required subject knowledge from this book.

Here in this book we the unit writers and editorial board have taken reasonable care to give maximum theoretical and practical knowledge to the students. Hope it will enable the students to get the adequate knowledge.

We are thankful to all the members of the Board of Studies, unit writers and the editorial board, without support of which it may not have completed.

Dr. P. V. Mohite
Chairman,
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B. Com Part-III

Semester V and VI

SIM IN ADVANCED ACCOUNTANCY PAPER II AND IV

INDEX

Each Unit begins with the section 'Objectives' -

Objectives are directive and indicative of :

1. What has been presented in the Unit and
2. What is expected from you
3. What you are expected to know pertaining to the specific Unit once you have completed working on the Unit.

The self check exercises with possible answers will help you to understand the Unit in the right perspective. Go through the possible answer only after you write your answers. These exercises are not to be submitted to us for evaluation. These are provided to you as Study Tools to help keep you in the right track as you study the Unit.

Unit - 1

Auditing

Structure

1.0 Objectives

After studying this unit you will understand :-

- Meaning of Auditing
- Scope of Auditing
- General principles of auditing
- Objectives of auditing
- Types of audit
- Importance of Internal check

1.1 Introduction

The Industrial Revolution in 1860 has changed the nature of business from small scale industry to large industries. It increased the volume of trading operations necessiting the use of more capital. The required capital was collected from various scattered share holders. The management of business is being done by employed (salaried) persons. Therefore the owner (shareholders) wants to know the financial positions of their business. It necessited the use of proper checking of accounts.

In the early stage of civilisation, the size of business houses were very small. The amount invested were also very less. A businessman himself records the transactions. Therefore there was no need to check the transactions by some other person. The transactions of public companies have to be checked by a third party. There were no special staff to check these transactions. The accounts were read before some impartial and experienced persons, ordinarily 'Judges' known as 'auditors'. They hear the accounts written by accountants and express their opinion about the correctness of the accounts. Thus the term 'auditor' literally means 'hearer' i.e one who hears the accounts. The word 'audit' is derived from the 'Latin' word 'audire' which means to hear.

In the last decade of 15^{th} Century Luca Paciolo, an Italian published the book 'Principles of double entry book - keeping' in 1494. This was only system of recording all types of business transactions. The history of auditing in India dates back to April 1914, when Indian Company Act 1913 was passed. This Act made it obligatory to every Company registered under this Act; to have the accounts audited at least once in a year. In the initial stage Bombay Government was conducting Government Diploma In Accountancy examinations. Thereafter under the Auditors Certificate Rules 1932 allowed to work as auditor. The Central Government established an Indian Accountancy Board under which Registered Accountants were allowed to work as an auditor.

In 1949 The Chartered Accountants Act came into force. It granted autonomy to the accountancy profession. In order to obtain it's certificates of Chartered Accountant a person has to follow the rules and regulations made by the institution.

1.2 Meaning and Definitions

Auditing is a scientific and systematic examination of books, vouchers and other financial and legal records in order to verify and report upon the facts regarding the financial condition disclosed by the balance sheet and profit revealed by profit and loss account. The person who does the work of examination of books of accounts is called as an auditor.

1.2.1 Definitions :

In the initial stage audit included only the ascertainment of the fact whether the accountant has properly recorded the receipts and payments of cash i. e. it was merely a cash audit. But today the scope of audit has much wider than that of previous. Following are some important definitions of auditing.

1. Spicer and Pegler : An audit is “such an examination of the books of accounts and vouchers of a business, as will enable the auditor to satisfy himself that the Balance Sheet is properly drawn up, so as to give a true and fair view of state of the affairs of the business and whether the Profit and Loss Account gives a true and fair view of the profit or loss for the financial period according to the best of his information and the explanations given to him and as shown by the books, and if not, in what respect he is not satisfied."

2. L. R. Dickesee : “An audit is an examination of accounting records undertaken with a view to establishing whether they correctly and completely reflect the transactions to which they relate. In some instances, it may be necessary to ascertain whether the transactions themselves are supported by proper authority.”

3. “Audit is an instrument of financial control. It acts as a safeguard on behalf of the proprietors agents or servants in realisation and utilisation of money or other assets. It also assures the proprietor that the expenditure and outgoing have been incurred with due regularity and propriety. The agency employed for this purpose is called an ‘Auditor’ " – Comptroller and Auditor General of India.

From the above definitions it is clear that the audit means –

(a) Examination of books of accounts with help of vouchers, evidences, information and explanations.

(b) The audit work is carried out by an independent person who is not connected with writing of books of accounts.

(c) To state whether the Profit and Loss Account and Balance Sheet show true and fair position of the state of affairs.

1.3 Scope of Auditing –

The scope and dimension of auditing greatly increased in severities. The evolution of new concept such as tax audit, management audit and operational audit. The primary audit objective of detection of the errors and frauds now shifted to the determination of the fairness and authenticity of reported financial position together with the detection and prevention of errors and frauds. This vastly enhanced the scope of auditing exhaustive rules and regulations were framed in all the countries of the world for conduct of independent professional audit.

An auditor certifies the correctness of the books of accounts and detects errors committed by the accounting clerk in the preparation of financial statements. If the verification is not conducted in proper and satisfactory manner, the result would be unreliable. There are various reasons due to which the financial books may be incorrect. The auditor should bring them to light and report to the owners of the business.

Thus as stated by shri A. K. Chanda, former Comptroller and Auditor General of India, "audit is not an inquisition and it's aim is not one of fault finding. Its purpose is to bring to notice of the administration lacuna in the rules and regulations and lapses, and to suggest possible ways and means for the execution of plans and projects with greater expedition, efficiency and economy."

Book Keeping, Accountancy and Auditing –

Book – Keeping, accountancy and auditing are the three aspects of Accountancy. The first part is a practical, second is theoretical and last one is analytical. Initially there was no difference in duties of book keeper and accountant. With the development industry and trade, book – keeping and accountancy have become separate functions. The following description makes this distinction clear.

Book – Keeping : It is the art of recording the daily transactions in the set of financial book. The book – keeper is mainly concerned with journalising, posting, totaling and balancing the various accounts in the ledger. This work is a mechanical work and does not require any special skill.

Accountancy : Accountancy begins where Book – Keeping ends. The work of Accountant, start when the job of book – keeper is completed. The accountant has to satisfy himself that the transaction have been properly recorded and posted in the books of accounts. He makes the trial balance agree. Then he prepares the final accounts after making necessary adjustments. He should have knowledge of accounting principles and basic skill of preparing the final accounts.

Auditing : Where accountancy ends, auditing begins. It involves verification of the entries passed by accountant and final accounts prepared by him. It is a work of scrutiny with the help of vouchers, documents and the information supplied him. The auditor has to satisfy himself about the authenticity of transactions. The auditor is required to submit his report to the effect whether or not the Balance Sheet is true and fair representation of the state of affairs of the business. Thus an auditor must be well – versed in accounting. The person having passed the examination of Chartered – Accountant (C. A) is qualified to work as an auditor.

Difference between Accounting and Auditing –

Point of Difference	Accounting	Auditing
Meaning	Accounting is recording of all day to day transactions in the books of accounts.	Auditing is a critical examination of the transaction recorded in the books of accounts.
Nature	It is concerned with finalisation of final trading result.	It is concerned with establishment of reliability of financial statement.
Object	The object of accountancy is to ascertain the trading result.	The object of auditing is to certify the correctness of financial statement.
Scope	Accounting limited to books of accounts only.	The scope of auditing is beyond the books of accounts.
By whom	Accounting work is done by employed persons of enterprise they do not need any special qualification.	Auditing is done by an independent person. The person doing the work of auditing must be a chartered accountant.

Point of Difference	Accounting	Auditing
Report	The accountant need not to submit his report.	The auditor has to submit his report to the appointing authority.
Responsibility	Accountant is responsible to management.	Auditor is appointed by owners / shareholders therefore he is responsible to shareholders.

1.4 Advantages / Necessity of auditing

Irrespective of the fact whether auditing is compulsorily or voluntarily or statutorily, there are numerous advantages of audit. These are grouped as follows :–

1. **Punctuality in accounting department :** The employee who records, maintains the books are always punctual, careful and systematic in their work.
2. **Moral check an employees :** Errors and frauds if any committed by employees are properly detected by auditor. Therefore there is a moral check on every employee.
3. **Determination of liability :** Liability of an enterprise regarding income tax, sales tax, wealth tax etc can be easily determined on the basis of audited statements of accounts.
4. **Credit facilitates :** Loans and credit may be obtained easily on the basis of audited statements. Because these audited statements are more reliable about the state of affairs of the institution.
5. **Comparison of accounts :** Audit enables comparison of accounts between two departments, companies or periods. It is useful for management analysis.
6. **Useful for partnership firm :** Partners can utilise the audited statements to settle their dispute regarding valuation of goodwill, adjustment in capital, at the time of admission / retirement of partner.
7. **Detection of weaknesses of control :** If there are any drawbacks & weaknesses of present internal control system it can be detected by auditor. He also suggests remedies to improve the internal control system.
8. Shareholders who resides at different statement from Head office reply on the

audited statements and can be sure about their investments.

9. Insurance companies also reply upon the audited statements of accounts for settlement of claims in respects of fire insurance etc.

10. The audited statements of a business are readily accepted as evidence in trade disputes.

Is auditing a Luxury ?

The following points have been given to prove that auditing is a luxury.

1. The remuneration paid to the auditor is a charge on profit and mere wastage of funds.
2. Auditing creates a lot of obstructions in daily routine of work and hence it is an unnecessary waste of time.
3. As auditing can not detect and prevent all the errors and frauds & it is of no use.

The above arguments are not sound and are based on illusory grounds. If accounting is a necessity, auditing is still more important. Auditing may not be necessity and legally compulsory in the case of small business houses where only small amounts of capital are invested and accounts are maintained in a very crude form. But for big business audit has a great practical utility. Every firm must maintain proper accounts and get them audited by some independent and qualified auditor. Hence, it is wrong to say that auditing is a luxury, while accounting is a necessity.

1.5 Basic General Principles of Auditing

Dictionary meaning of the word 'principle' is fundamental truth, a primary or basic law or doctrine; a settled rule of action. Though the principles of auditing are not as finely developed as the principles of accounting, the following fundamental principles of auditing have evolved over the years.

1. **Principles of Independence** : Independence is a basic need of auditing, without it objectives of auditing cannot be obtained with all fairness.

2. **Principles of objectivity :** Auditing must be conducted objectively. The auditor must be free from bias, emotions and whims; while auditing.

3. **Principles of full disclosure** : The client should provide to the auditor all possible evidence, explanation and records. The principle implies that the auditor should make full disclosure of his findings.

4. **Principles of materiality** : This principles indicates that more attention must be paid to those items which are materially important and in the areas where the risk of error / fraud is relatively more.

1.6 Objectives of Auditing

As stated by L. R. Dicksee, initially the object of audit was to detect errors and frauds. For this purpose an auditor has to do detailed checking of transactions. But with fast changes in the volume and size of business, this object becomes a subsidiary. Now the **primary object** is to verify the accounts and statements with the view to confirm their accuracy and ascertain whether the final statement shows true and fair view of the state of affairs of the concern. The **primary object** of the audit is to examine the system of internal control and internal checks. The auditor must satisfy himself that no fraud or error has been committed by management, partners or employees.

Secondary Objects of Audit –

A) Detection and prevention of errors and

B) Detection and prevention of frauds

A] Detection and prevention of errors :

Errors means human mistakes in recording, posting, calculating. Such mistakes / errors takes place due to ignorance or negligence on the part of clerical staff.

Types of errors :

1. Errors of omission.
2. Errors of commission.
3. Errors of principles.
4. Compensating errors.

1. Errors of omission : When a transaction remains to be recorded in the books of accounts wholly or partially, it is error of omission. If it is omitted wholly it does not affect the agreement of trial balance. Such errors cannot be detected easily. But if the transaction is recorded partially, it will affect the agreement of trial balance.

2. Errors of commission : When entries are wrongly entered in the books of account, wrong casting, wrong calculations, then it is known as errors of commission. These errors can be easily detected as they affect the agreement of trial balance.

3. Errors of principles : Such errors takes place when proper allocation of expenditure / income is not made according to the fundamental principles of accountancy. When capital expenditure / income is treated as revenue expenditure / income & vice-versa. Then it is said to be errors of principles. This types of errors cannot be detected easily, as they do not affect the agreement of trial balance.

4. Compensating Error : When an error is made for counterbalance of any other error or series of error it is said to be compensating error. When trial balance does not agree, the difference is adjusted by showing more or less amount on debit / credit side of trial balance. Such errors do not affect the agreement of trial balance.

B] Detection and prevention of frauds :

Fraud means intentionally making a wrong entry or false representation with a view to deceive others. Frauds are done by top management with planned manner. Following types of frauds are usually made in accounts.

(i) Misappropriation of cash or goods or

(ii) Defalcation of accounts

(i) Misappropriation of cash or goods : This may committed either by omitting to enter receipts or by entering fictitious payments. Misappropriation of goods is more difficult to detect, unless accurate stock records are kept.

Teaming and Lading -

This is one type of fraud prepared by cashier. Cash received from a debtor is neither recorded in cash book nor to that debtors account but it is appropriated by cashier. On receipt of cash from another debtor; account of first debtor is credited and on receipt of cash from third debtor, second debtors account is credited and so on. This process goes on till the fraud is detected. Thus under this method past defalcations are covered up by the present receipt. Such frauds are very difficult to discover. The auditor should check the internal check system and use his professional skill to detect such appropriations.

(ii) Defalcation of accounts : It is generally done by people at the top, such as directors or manager to boost the image of the company by showing fictitious profit or show less profit to avoid tax liability or to create secret reserves.

1.7 Types of Audit

Chart Showing Different Classes of Audit

[A] Based on Authority
- Statutory Audit
- Non Statutory Audit
- Internal Audit

[B] Based on Scope
- Complete Audit
- Partial Audit

[C] Based on Time
- Continuous Audit
- Final Audit
- Interim Audit

[D] Based on Objects
- Special Audit
- Cost Audit
- Management Audit
- Service Audit

[E] Other Types
- Balance Sheet Audit
- Tax Audit
- Cash Audit
- Operational Audit
- Social Audit
- Efficiency Audit

Internal Audit :

"In its narrow sense, such an audit is one that is carried out by the specialist staff of the organisation being audited, and concern itself mainly with the routine checking of accounting transactions on a daily basis, with the object of quickly locating irregularities thus making it more difficult to perpetrate a fraud, because of the constant nature of checking" – H. Washerbrook.

This type of audit is optional. It is conducted by the internal auditor who is appointed to the proprietor. Even the employee of the orgnisation may be appointed as an internal auditor to examine the books of accounts. All the terms & conditions of audit work are determined by the agreement. The basic purpose of internal audit is not only to examine the books of accounts but also to review the present working and make valuable suggestions to improve it.

The purpose behind internal audit is to assure the management that the accounts are being properly maintained and the system provides adequate safeguards for detection and prevention of any fraud. The scope and objective of internal audit vary from business to business. It may even extend to accounting aspect. It is a part of the system of internal control.

Objectives of Internal Audit –

1. To verify the accuracy of the records
2. To ensure that the transactions have a proper authority
3. To facilitate prevention and detection of frauds and errors
4. To ensure that purchase and sale of fixed assets is authorised
5. To improve the system of internal check.
6. To examine the protection given to fixed assets.
7. To make investigations for management
8. To review the entire system of working and make it more effective.

External / Statutory Audit –

Statutory audit is compulsory under an statute or law. It can be conducted by a qualified chartered Accountant, whose rights, duties and liabilities are determined by the concern statute. The duties and rights may be extended by an agreement between the auditor and concerned institution. This audit is compulsory under statute in the following cases.

(a) Companies : The companies Act 1913, made audit of companies registered under the Act, compulsory for the first time in India. The companies Act 1956 as amended upto date has made significant changes in rights, duties and powers etc, of an auditor. Qualification of an auditor have been laid down in section 226 of the Act.

(b) Other institutions : Audit is compulsory in case of the following institutions.

(i) Banking companies governed by Banking Companies (Regulation) Act 1949

(ii) Insurance companies governed by the respective Insurance Acts.

(iii) Co-operative societies registered under the Co-operative Societies Act.

(iv) Public and charitable trusts registered under various concerned Acts.

(v) Local authorities, Government undertakings and departments.

(vi) All business organisations having annual sales over prescribed limit.

Essential characteristics of statutory audit

(i) It is mandatory in nature

(ii) The auditor must be a qualified chartered Accountant or a cost and works accountants for permitted audit only.

(iii) The auditor must not — any prescribed disqualification during the course of audit

(iv) Appointment of auditor is made as per the provisions of the relevant Acts.

(v) It is always a complete audit

(vi) It enables the appointing authority to get full disclosure of all material facts

Difference between Internal and External Audit

Internal Audit	External Audit
Internal auditor is appointed by the management.	External auditor is appointed by shareholders.
There is no any specific qualification for internal auditor.	External auditor must possess the qualification of Chartered Accountant.
Internal audit may be for any period.	External audit generally covers one accounting year.
Internal auditor is responsible to management.	External audit is responsible to shareholders
Scope of internal audit is determined by the management.	Scope of external audit is determined by law.
Internal auditor can not apply test check.	External auditor can apply test check if the internal control system is effective.
Remuneration of internal auditor is fixed by management.	Remuneration external auditor is fixed by shareholders.

1.8 Internal Check

Meaning of Internal Check: The internal check is a part of the whole system of internal control and is best regarded as the checks on the day-to-day transactions. The term '*internal check'* implies organization of the system of accounts of an office or factory and an arrangement by which the duties of the various members of the staff of a business are allocated in such a way that the work done by one person is automatically checked by another and thus the possibility of fraud, or error, or irregularity is minimized. In internal check, no one person is made responsible for all phases of a transaction.

L.R. Dicksee defines Internal Check as "such an arrangement of book-keeping routine that errors and frauds are likely to be prevented or discovered by the very operation of the book-keeping itself".

De Paula defines it as "Internal Check means practically a continuous internal audit carried on by the staff itself, by means of which the work of each individual is independently checked by other members of the staff".

According to Professor Arnold W. Johnson, "Internal Control System and verified by the work of another employee- both employees, working independently and without duplication of each other's work".

From above discussion and definitions it can be observed that:

i. The internal check is an integral part of the whole system of internal control.

ii. Internal check means the check imposed on day-to-day transactions.

iii. Internal check includes matters such as allocation of authorities, division of work and proper methods of recording transactions, etc.

iv. No single employee is allowed to carry out himself complete work from start to finish. And work is divided among more persons. Thus, the system is based on the principle of division of labour.

v. An arrangement of work is made in that order that the work of one employee is automatically checked by the another employee. It means, the work of one person is complementary to that of another.

vi. There is no duplication of work.

vii. Errors, frauds and misappropriations are detected at early stage.

The main objective of internal check is to prevent and alternatively make early detection of frauds, errors, waste and misappropriation.

It is also noted that, the internal check system is more useful to big concerns. And in a small concern, this system is not practicable. In internal check system, one person should not be in charge of any one important aspect of business. The work of each employee should change from time to time without prior notice. One person should not be in charge of one aspect for a long time. Accounting procedures must be reviewed periodically. There must be regular stock-taking of inventory and discrepancies must be looked into. There must be physically verification of various assets.

Importance of Internal Check for Audit: The soundness of the system of internal check and the manner it is carried out are the matters of fundamental importance to the auditor. The internal check system largely determines the nature and extent of the scope of auditor's work. If there is an efficient system of internal check, the work of an auditor becomes quite easy. A good and effective system of internal check relieves the auditor of a large part of detailed checking of the transactions and he may give his attention to more important sections of his audit work.

In order to know effectiveness of internal check system, the auditor should carefully study the system in force in the organization. He should apply few test checks and if results are satisfactory, he may safely rely on it. In case he finds that internal check system is not satisfactory, then it would be necessary to him to check all the transactions from the beginning to the end. Thus, existence of a good internal check system helps an auditor to a great extent in the conduct of his work but does not reduce his legal liability. The better the system of internal check in an organization, the larger can be the extent of test check by the auditor, e.g. in case of payment of wages, he should compare the attendance of the workers with the gate keeper's record, foreman's record, the wages sheet and the cash book. But wherever the auditor feels that there are weak centres of loopholes, he should exhaustively check all the records.

The auditor is the best outside agency to properly evaluate the internal check system within the organization. He should thoroughly go into the system of internal check. He should, in such circumstances, bring this fact to the notice of the management and shareholders also. He should also suggest the changes he feels necessary to strengthen the system of internal check.

Due to internal check system, it is possible to get the auditing work done from the employees. Internal check system can be applied for Cash Receipts and Payment, Credit Purchase and Sales, Payment of Wages, Cash Sales, Stores of a large manufacturing concern, etc. If the internal check system is efficient, it minimizes work load of an auditor. Internal check system creates sense of responsibility among the employees, therefore employees are performing their operations carefully, so audit work is becoming easy and will complete within stipulated time. Because of internal check system the volume of auditor's work is reduced. It saves time of the auditor. Internal check system is a good substitute for detailed checking for those business houses where it is impracticable to check each transaction.

1.9 Key words

1. **Final Accounts :** The accounts which are prepared at the end of Accounting year
2. **True and Fair view :** Real and factual financial position of company's state of affairs
3. **Frauds :** Misappropriation of cash or goods and manipulation of accounts to deceive others

1.10 Self Assessment Questions

Q. 1 : State meaning and scope of auditing ?

Q. 2 : Explain the advantages of auditing ?

Q. 3 : What are the general principles of auditing ?

Q. 4 : State the difference between accountancy and auditing ?

Q. 5 : Explain the necessity of auditing ?

Q. 6 : State and explain the types of errors ?

Q. 7 : What is internal audit ? Give it's objects ?

Q. 8 : What is external audit? Explain the characteristics of statutory audit ?

Q. 9 : What is auditing ? Explain it's objectives ?

Q. 10 : What is internal check? State it's importance for audit.

Q. 11 : Write short notes on the following :-

(a) Teaming and Lading.

(b) Objects of Internal Check.

(c) Internal Audit.

(d) Statutory Audit.

(e) Internal Check.

(f) Principles of Auditing.

1.11 References for further study

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Unit - 2

Vouching

Structure

2.0 Objectives

After going through this unit you would be able to understand -

- The meaning and nature of vouching.
- The importance of vouching and auditors duty in relation thereto.
- The important points of vouching.
- The vouching of cash transactions.
- The vouching of credit purchases and sales.
- The meaning and need of investigation.
- The meaning and nature of Verification and Valuation of assets and liabilities.
- The difference between Vouching & Verification and Verification & Valuation.
- The basis of valuation of various assets and how they are valued.
- The position of auditor in connection with verification & valuation.
- The Principles of Verification and Valuation of Assets.
- Verification and valuation of some common assets and liabilities.

2.1 Introduction

It is one of the major responsibilities of the auditor to see all the transactions are properly accounted for and these are supported and substantiated by authentic documentary evidences. Every transaction must be supported by proper written evidences which could prove that the transaction has actually taken place. *A documentary proof or evidence in support of a transaction is called a voucher.* It may be any of the following forms -

Receipts	**Counterfoils**	**Carbon copies**	**Cash/Credit Memo**
Pay Sheets	Bills	Bank Challans	Bills Receivables
Bills Payables	Letter of Collection	Purchase Order	Invoice
Dividend Warrant	Bank Pass Book	Material Requisition	Delivery Note
Account Sales	Purchase Note	Sales Note	Attendance Register
Wage Records	Minute	Resolution	Goods Received Note

Gate Keeper's Book	Order Book	Store Keeper's Book	Correspondence
Inward/Outward Register		Agreement / Deed / Contract	
Bank Pass Book	Interest Warrant	Bank Advice	Broker's Note

Statement of Accounts (Confirmation) from Debtors & Creditors, Investment certificates
Certificate from Architect, Engineer, Solicitor, Valuer etc., Job Cards etc.

Vouching means examination of the entries in the books of accounts with sufficient written evidences to satisfy the auditor himself about the authenticity, accuracy, validity and authority of the records. The following definitions explain the meaning of vouching.

'Vouching means verification of authoritative and authenticity of the transactions recorded in the books of accounts'. **- R. B. Bose.**

'Vouching is a technical term which refers to the inspection of documentary evidence supporting and substantiating a transaction by the auditor'. **- R. A. Irish.**

'Vouching does not mean merely the inspection of receipts with the transactions of a business together with documentary and other evidence of sufficient validity to satisfy an auditor that such transactions are in order, have been properly authorized and are correctly recorded in the books.' **- De Paula.**

2.2 Characteristics of Vouching

From the above discussion and definitions we can know that vouching is not merely to check the records in the books of accounts but to verify the proofs of the transactions recorded. The main characteristics of vouching can be stated as below-

1. It is an examination and verification of entries recorded in the books of accounts with supportive documentary and related evidences.
2. It is an examination of vouchers.
3. It is a process of ascertaining corrections and authenticity of the transactions.
4. It ascertains that whether all the transactions are related to the business and there is no omission in recording the transactions and at the same time no fraudulent entries are passed in the books of accounts.

5. It ascertains that the transactions have actually taken place and it is within the limit of authority.
6. It is the first step in auditing because it is related to the prime document of evidence and entiries in the primary books.

2.3 Objectives of Vouching

1. To see whether the transactions which are recorded are related to the business.
2. To see that the transactions are actually taken place.
3. To verify authority and authenticity of every transaction.
4. To find whether any transactions has left off to be recorded.
5. To see that all the transactions are properly accounted for in the books of accounts.
6. To see that no faudulent transactions are recorded.
7. To see that for all the transactions there are supporting documentary evidence.

2.4 Significance of Vouching

While auditing the books of accounts it is expected that an auditor should not satisfy himself with the results of records but he has to go beyond the books of accounts and verify the existence and correctness of records. The degree of quality of auditing mainly depends upon the quality of vouching. *Audit starts with vouching and so all the subsequent steps in auditing and the success or failure of audit work are mainly depend on vouching.* De Paula has rightly said that 'Vouching is the essence of auditing.'

Vouching reveals the truth of entries in the books of accounts. *The validity, authenticity and correctness of the vouchers i.e. prime evidences and its proper accounting is being checked by the way of vouching.*

One of the objectives of audit is detection of errors and frauds. In this regard vouching is of great help to an auditor. It points out errors and frauds in the books of primary entries and hence, its reflection in further accouting can be easily detected. *It means vouching is a base of auditing with the help of which auditor can proceed well further and can certify the accounts.*

Vouching proves whether the final accounts reflect true and fair view of the state of affairs of the business. Vouching is the process of checking entries in the books of original records on which entire accouting of the business is based upon. *Vouching ensures original entries by checking genuineness and authenticity of transactions and their postings in the books of accounts are made as per the principles of accouting.*

Vouching verifies first the documentary and other related evidences which are the basis of entries. *It points out the fraudulent and wrong vouchers and thus helps an auditor to find out errors and frauds at the initial stage of auditing.*

Vouching alerts an aduitor by pointing out errors and frauds at the beginning of auditing. If there are some mistakes in vouchers and original entries or there are some fraudulent vouchers, auditor will become alert and he will exercise careful complete checking and would not resort on test checking.

From all the discussion we can conclude that *vouching is not merely checking the documentary evidences but the auditor should satisfy himself that the transactions or entries are in order, they are properly authorized and correctly recorded in the books of accounts following the accounting principles.* For example, the auditor should not rely ony on the receipt of the creditor for the payment made to him but he has to confirm that the goods are purchased from him on credit, of the given value after proper sanction from the competent authority and as per the agreement the payment is made by cheque. If the payment is made in cash, he should enquire why the payment is made in cash. He should also verify the accounting entry passed in the books of accounts.

2.5 Important points to be considered while vouching transactions.

Let we will study the main points which will make vouching effective and efficient.

1. Serial : All the vouchers must be serially arranged and numbered according to date and entries in the books of accounts. The entries in the books of accounts should also bear the serial number of vouchers that will easy to correlate the voucher with the particular entry.

All the vouchers should also be filed serially and properly. The files should be given serial numbers and the period should be mentioned clearly at the front of the file. These are also to be arranged serially, Otherwise the auditor will loss his valuable time in searching the right vouchers.

2. Date, Amount and Name : There is a chance that the voucher of the same date of the last month or year may be produced again so, auditor should check the date of voucher carefully.

The voucher should contain the amount both in figure as well as in words. The auditor should see that the amount tally with the amount entered in the books of accounts.

Each voucher should be in the name of the business concern and not in the name of any individual i.e. official or partner or director. The vouchers of personal name should be rejected or should check other relevant documents to confirm that the voucher is related to the business. He should also confirm the name of the party issuing the voucher.

3. Particulars : The nature of item matters. If the capital item recorded as revenue or vice versa, it affects greatly final statements of the concern. So, the auditor should read particulars column on the voucher carefully and ascertain the nature of item. Check the postings made accordingly. Besides from the particulars the auditor can ascertain head of account, title of the account, debit or credit effect of the transaction etc.

4. Validity of Voucher : As far as possible the vouchers should be in printed form and wherever necessary it should bear revenue stamp also. At least the voucher should bear stamp of the receiving party. For petty expenses there may not be such vouchers so, auditor should take more regarding these vouchers because chances of fraud can not be denied.

5. Period : The period of the item is much important. Receipts and payments may relate to the previous year, current year or next year. Entries are passed taking into account the period to which it relates. Prepaid or pre-received items as well as received in advance and paid in advance items should be properly accounted for taking into account any provisions or reserves made. The auditor should pay careful attention towards this.

6. Other Precautions :

(a) As far as possible vouching of a particular period should be made at a stretch.

(b) Checked vouchers and related documents should be marked with stamp, signature or both so that they can not be reproduced.

(c) List of rejected vouchers should be made and they should be kept away from the particular voucher file or in a separate file.

(d) List of missing vouchers is also to be prepared and the relevant documents must be checked more carefully.

(e) In the case of duplicate vouchers, auditor should be more alert and get information till he satisfies regarding why there is duplicate voucher. All the relevant documents must be checked more carefully.

(f) Auditor should satisfy himself that entries are passed correctly in the books of accounts. Checked entries should be marked with particular sign or tick mark. Explanation should be collected regarding unticked items and these items be compared with missing vouchers for confirmation.

(g) Doubtful and torned or spoiled vouchers should be checked carefully. These are to be consulted with responsible officer.

(h) In any case help should not be taken from the employee of the concern in respect of vouching.

(i) All his experiences and observations should clearly be noted down which will become part of his report.

2.6 Vouching and Auditor

Auditor will be held responsible for any loss to his client due to negligence or carelessness of auditor in respect of vouching. So he should exercise his skills, knowledge and techniques to his best while vouching.

It is expected that the auditor should not mere compare the figures from vouchers and the entries in the books. He should go beyond the books and found that –

- the transaction has taken place,
- the transaction has related to the business,
- the transaction has effected under proper authority,
- the transaction is recorded correctly in the books of accounts,
- there are sufficient primary and collateral documentary evidences which proves the transaction is authorized, authenticated and approved.

2.7 Vouching of Cash Transactions

Cash Book is prime important book. It consist entries of all cash receipts and payments. As the cash is more important and sensitive item, auditor should be very careful while carrying on vouching in respect of cash transactions. The auditor should see that –

- all the receipts and payments are recorded in the cash book with right figures,
- all the receipts and payments are recorded under proper headings,
- all the payments are approved by responsible officer,
- no receipt is omitted to record,
- no fictitious or fraudulent or unauthorized payment is recorded and
- all the calculations are made correctly.

Before starting vouching of a cash book, internal check system must be examined carefully. If the internal check system is doubtful or suspicious the auditor should follow hundred percent vouching. The auditor should ascertain whether a rough cash book or diary has been maintained, process of receiving cash and making payments in respect of various types of transactions, process of banking and withdrawing cash from banks, authority approving the payments and signing cheques etc.

He should confirm that – a) all unused books of accounts and books of receipts and other vouchers are kept in custody of a responsible officer, b) there are specific rules regarding allowing cash and trade discount, c) spoilt or torned vouchers are not destroyed but are attached with marking as 'Cancelled'

We can divide the process of vouching of cash book in two parts – Vouching of Receipts and Vouching of Payments

2.7.1 Vouching of Receipts

In general receipts side of cash book includes the following items –

1. Opening Balance
2. Cash Sales
3. Cash from Debtors
4. Bills Receivables Discounted and Matured
5. Non-operating Income
6. Other Income
7. Sale of Investments and Fixed Assets
8. Claims Recovered

9. Subscriptions

10. Other Receipts

11. Loans Taken

12. Issue of Debentures

13. Issue of Shares

1. Opening Balance : The auditor can verify it by comparing the figure mentioned in the audited balance sheet of the last year and the closing balance of the cash book of the last year.

2. Cash Sales : The auditor should examine fully the (a) Cash Memo, (b) Summary Sheets of Salesman, Cashier, and Delivery Clerk, (c) Daily Cash Register, (d) Abstract of Discount and the Rate of Discount. Then he should compare the amount, date and particulars with the entries made in the cash book.

3. Cash from Debtors : First the auditor should examine the following thoroughly–

(a) Carbon copies of the Receipts issued by the business concern,

(b) Correspondence with the debtors such as demand letter, reminder letter etc.,

(c) Rate of Discount and the sanctioning authority,

(d) Amount of Bad Debts and approving authority,

(e) Daily list of Debtors from whom cash or cheques are received,

(f) Statements of Confirmation of balance from debtors.

Then he should verify there details such as date, name, particulars, amount etc. with the entries made in the cash book. There is chance of making fraud by –

- recording less amount to the debtors account,
- recording the amount after few days,
- showing part amount as discount which is not allowed or showing more amount of discount than allowed,
- recording the amount received as bad debt,
- teaming and lading – embezzling cash received from one debtor and recording cash received from another debtor to the account of first debtor,

from next debtor to the account of second debtor and so on. This process is carried till making any adjustment of that much amount or redepositing the remaining amount.

To detect such type of frauds auditor should verify accounts of debtors simultaneously and insist that debtors should send their confirmation of balance directly to him.

4. Bills Receivables discounted and matured : The auditor should examine Bills Receivable Book, Bills Discounted Book and Bank Pass Book. He should also confirm the name of the drawee, date of drawing the bill, period, endorsement of the bill, rate of discount etc. He should make enquiry about the bills dishonoured and steps taken for recovery of the amount i.e. whether the bill is renewed or recovered by other way. If the bills are honoured before the due date (retirement) and discount is allowed, he should check the rate and amount of discount and the authority deciding the rate of discount.

5. Non Operating Income : Interest on fixed deposits should be verified with the fixed deposit receipt and bank pass book.

Interest on loan advanced could be verified with the agreement of loan with the borrower and receipt issued for interest.

Interest on investment could be examined with the bonds or certificates of investment, interest warrants and bank pass book.

Dividend could be verified with the dividend warrants and with the share certificates.

The auditor should confirm himself that interest and dividends are received in time or whether there is any outstanding portion. He should make actual calculations of interest.

For checking the rent, along with the receipt he should go through the lease agreement and verify the amount of rent, period (monthly, yearly etc.) and mode of payment etc. He should see that rent is received in time and if there is any rent received in advance it is properly recorded. If the rent is collected through agent, agent's register should also be checked and if tenant is paying rent by depositing cash or cheque directly in the bank account of the client, cross checking with the bank pass book should also be exercised.

6. Other Income : Commission received should be checked with the carbon copy or counterfoil of the receipts issued. In addition to this he should go through the commission agreement to know the rate of commission and period of payment. He should calculate practically the amount of commission by taking sales figures from statement of sales.

For checking commission on consignment, he should verify account sales and statement of accounts. Confirm the rate of commission and del-creder commission by reading the agreement and make actual calculation of commission. Also check outstanding commission has rightly accounted or not.

Receipt issued for royalty received and the lease agreement are the vouchers which can be examined for confirming amount of royalty. He should go through the lease agreement to know the rate of royalty, minimum rent, recovery of short workings etc. Actual calculations should be made based on the statement of production or output or sales. Special enquiry should be made if minimum rent is revised to know under which circumstances it is revised and how long it was continued or will continue.

Other income will be verified with the help of receipts, related documents, correspondence in this regard, related books of accounts or registers, bank pass book etc.

7. Sale of Fixed Assets and Investments : While vouching sale of fixed assets the auditor should examine receipt issued, resolution passed or minute book, tender notice, broker's or auctioneer's note and related correspondence. Then he should compare the figures and particulars with the entries in the cash book. As well he should examine whether the profit or loss on sale is correctly calculated and transferred to capital reserve account. If any asset is sold as scrap, loss is transferred to profit and loss account.

While vouching sale of investments along with the above vouchers (related to sale of fixed assets), he should also enquire whether sales is made ex-dividend or cum-dividend and see the profit or loss is properly accounted for. If investments are matured (e.g. bonds), he should ask for the correspondence in this regard and compare the amount and particulars with the certificates of investments, maturity value, letters and bank pass book.

8. Claims Recovered : If the client has recovered and claim against any insurance such as fire insurance, marine insurance or miscellaneous insurance, the auditor should carefully examine the statement of loss and claim. Receipt, insurance policy, correspondence, bank pass book etc. are the vouchers that will confirm the figures and particulars.

If claim is recovered from railway or any transportation company the auditor should check the statement of goods or materials sent for transportation, acceptance letter of transportation company or railway receipt, statement of goods or materials destroyed or lost, statement of claim, correspondence and bank pass book. In both the cases he should check that the loss is properly accounted for.

9. Subscription : If the client is non-trading organization, the auditor should examine subscriptions received carefully because it is a main source of income of such organizations. For vouching of this item an auditor should examine the carbon copies or counterfoils of receipts issued and list of members.

He should check carefully – (a) subscriptions received in advance, (b) subscriptions outstanding for the year, (c) subscriptions received in the previous year for current year (paid in advance in last year), subscriptions received in the current year for last year (outstanding of the last year received in the current year) and subscriptions for last year still outstanding.

All these should be properly recorded in the books otherwise the income and expenditure account and balance sheet will not show true and fair view.

10. Other Receipts :

(a) The Bad Debts Recovery : The amount received from any debtor or liquidator or the Official Receiver which is written off as bad debts in earlier years, should be credited to the bad debts recovered account and not to the debtor's account. The auditor should see whether it is properly accounted and vouch this item with the help of receipts issued, dividend warrant from the Official Receiver and the related correspondence.

(b) Refund of Income Tax : if the tax deducted at source and tax paid in advance is more than the actual tax, the income tax authority refund the excess tax paid together with interest. The auditor can verify the amount of refund with the help of assessment order and refund order by income tax authority, return filed by the client and bank pass book. He should also check that proper entries are passed in the books of accounts.

(c) Receipts from Hire Purchase : The auditor should first go through the Hire Purchase Agreement to understand the hire purchase price, mode of payment, period of payment (monthly, yearly etc.) etc. He can vouch it with the help of receipt issued and actual calculation of interest.

If any goods are reposed then he should check carefully the value of goods repossessed, profit or loss on repossession, expenditure incurred for repairs and resale of goods reposed and the accounting entries passed in this respect.

According to nature and type of business there may be some other miscellaneous receipts. The auditor can check receipts, agreements, correspondence and other related documents and can make calculations wherever necessary to verify their correctness.

11. Loans Taken : Generally business concerns borrow from banks and financial institutions or from some other lenders. In such case the auditor should not check only the receipts but verify resolution passed and the agreement to know the total amount of loan, mode of disbursement, rate of interest, repayment conditions, securities given etc.

If the loan is taken from government authority and if there is any subsidy, he should also check the conditions, rate and amount of subsidy and whether it is properly recorded in the books of accounts.

12. Issue of Debentures : The auditor should go through first the resolution passed for issue of debentures to know the quantum, nature, rate of interest, face value, discount / premium etc. He should examine thoroughly list of applicant and the number of debentures demanded, statement of allotment, counterfoil of certificates of debentures issued and bank pass book.

He should also examine the premium or discount on debentures, forfeiture of debentures (if any) are properly accounted for.

13. Issue of Shares : The auditor should examine first the resolution passed for issue of shares so that he can know the number, type, face value, discount or premium, installments etc. In addition to this he should check -

(a) Prospectus issued by the company,

(b) Share Application Sheet,

(c) Share Allotment Sheet,

(d) Board's Resolution regarding allotment of shares,

(e) Adjustment of excess money received with application,

(f) Underwriting Contract,

(g) Provision of Article regarding issue of shares,

(h) Bank Pass Book,

(i) Counterfoils of Share Certificates etc.

He has to check whether any shares are forfeited and reissued and these are properly accounted for.

2.7.2 Vouching of Payments

Generally payment side of Cash Book includes –

1. Cash purchases
2. Payment to creditors
3. Payment of wages
4. Payment of salaries
5. Other expenses
6. Bills Payable honoured and retired
7. Payment against loans and advances
8. Purchase of investments
9. Purchase of fixed assets
10. Other payments and expenses

1. Cash Purchases : While vouching cash purchases the auditor should verify cash memos, goods inward register, counterfoils of cheques issued, bank pass book, receipts from suppliers etc. He should compare the figures and particulars from the above vouchers with the cash book entries. Entries in the cash memo or inward invoice should tally with the entries in the goods inward book. He should see that all purchases are recorded to the purchases account and not to any other account.

2. Payment to Creditors : It should be vouched with the receipts issued by creditors and bills. The auditor should see the contract and correspondence also. To verify that receipts are original and not the dummy he has to check the posting made to creditors account and wherever doubt he should have the confirmation from the respective creditors. Generally the payment is made by cheques so, counterfoils of cheque book should also be checked. If discount is allowed see that it is approved by the authority and it is properly accounted for.

3. Payment of Wages : While vouching payment of wages, an auditor should take utmost care and exercise all his skills and techniques because it is the item where chances of frauds are higher. Where number of employees particularly low grade workers, casual workers and workers on daily wages are higher, the chances of frauds are considerable. An auditor should verify that –

- the number of workers are correct,
- the rate of wages are correct,
- the calculations of wages are correct and the wage sheet is properly signed by the employee who has prepared, who has checked and who has sanctioned with the stamps of their designations.

As far as possible separate wage sheets should be prepared for those workers who are working on time basis and who are working on job or piece work basis. The auditor should examine attendance register and statement of allotment of piece work or job cards.

If the wages are paid on pay scale basis he should check the calculation of wages and deductions and see they are properly recorded in the books. He should discuss with the competent authority regarding the procedure of appointing casual and daily wages workers. Wage sheets, bank pass book, counterfoils of cheques issued etc. should be checked carefully and compare the figures with the entries in the cash book.

4. Payment of Salaries : The payment made to officers and employees of office for services rendered on monthly basis is called as salary. The auditor should check that the amount of salary sheet tallies with the amount shown in the cash book and with cheque drawn for this purpose. He should see that the gross salary is entered on the payment side and all deductions are entered on the receipts side.

He should also verify – a) increments given and increments stopped, b) payments made other than salary are not included in salary sheet, c) deductions are properly recorded to respective accounts and their payments are made in time, d) total amount of salary of every employee tallies with the amount shown in the Form No. 16 of Income Tax and e) if the salary is paid on package basis, proportionate amount is entered in the salary sheet and the total amount is equal to the amount as per the agreement.

He should also check overtime pay, remuneration for extra work, honorarium etc. carefully. All the calculations, castings and totals should be confirmed.

5. Other Expenses :

(A) Commission : Commission paid to agents, travelling salesmen, dealer and consignee can be verified with the help of receipts, agreements, account sales, counterfoils of cheques, bank pass book, statements of sales& orders received and other correspondence.

The auditor should check the rate of commission and actual calculations should be done to verify the figures of commission. If del creder or incentive commission is given, see whether it is as per the agreement.

(B) Travelling Expenses and Allowances : The auditor should first go through the rules regarding the travelling expenses and allowances. He should see that the voucher is supported by all the evidences regarding the purpose, place, travelling expenses, local conveyance, lodging & boarding charges etc. and all these are approved or sanctioned by the authority. If any advance is given for the purpose see that it is adjusted to the advance account and remaining amount is paid to or received from the employee and it is properly accounted for. If travelling allowance is given irrespective to the actual expenditure, see that it is within the prescribed limit and sanctioned by the authority. Travelling expenses and allowance paid to directors and extra ordinary type of travelling be checked very carefully.

For vouching this item an auditor can verify receipts, tickets, bill of hotels, vouchers for other conveyances, attendance or participation certificate from the authority, prescribed rules etc.

(C) Insurance Premium : The auditor should examine the policy or cover note and the receipt for the first or renewal premium. He should also check the period to which it relates. If part of the premium is related to the next year see that it is debited to prepaid insurance account.

(D) Freight, Carriage, Octroi and Custom : The auditor should examine the bill and receipt of shipping company, the bill of shipping agent, railway receipt, receipt for octroi, receipt for custom duty paid, bill of entry, counterfoils of cheques etc. He should also enquire for goods received note and goods cleared note. Evidences for other expenses such as port trust charges, weightmen expenses etc. are also be verified. See that rebate and refund (if any) are properly adjusted and accounted for. If expenses are related to fixed assets see that these are debited to respective asset account.

(E) Bank Charges : It means amount charged by bank for rendering services such as issuing demand drafts, collecting bills and cheques, discounting bill, collecting other income or making payments of any expenses etc. It should vouch with the help of bank pass book, bank statement and bank advice.

(F) Postage : While vouching postage, an auditor should examine postage (outward) register and franking pass book (where franking machine is used) and the figures should be compared with cash and petty cash book entries. If advance is given for postage expenses, see that expenses against this are properly accounted for. Postal stamps in hand should also be checked. He should also verify that all the expenses are related to business.

(G) Petty Cash Expenses : An auditor should verify the receipts, vouchers, cash memos, bills etc. and these are to be compared with the petty cash book. He has to check the balance on petty cash book with actual cash on hand and compare the amounts recorded in petty cash book as amount given for petty expenses and the amount recorded in petty cash book. He should see that petty cash book is checked periodically by the authority. If it is maintained on imprest system he has to check that the particular amount is kept as opening balance by giving amount equal to the expenditure of the last month.

(H) Directors' Fees, Allowances and Remuneration : For vouching the item the auditor should first examine the amount of fees, allowances and remuneration as mentioned in the article of association or as decided by the resolution passed in the meeting of board of directors or shareholders or as sanctioned by the government or as prescribed by the Companies Act. Then he should vouch the payment with the minute book of board of directors, directors' attendance register and receipts. He should confirm that the ceiling limit under the act is not crossed.

(I) Rent, Rates and Taxes : For vouching rent the auditor should examine agreement and the receipts. He should verify outstanding balance of last year paid in the current year and amount paid in advance and see that these are properly accounted for. For rates and taxes he should verify the bills and receipts and the period to which it relates. Outstanding amount paid and advance payment made should also be checked.

(J) Advertisement : Now a day huge amount is being spent on advertisement. First the auditor should examine the resolutions passed for advertisement containing the decisions regarding media, form, frequency, agency, ceiling limit of expenditure etc. He should vouch the bills and receipts of the advertising agency or of the press or of the office of the company working in particular media. If there is contract with a particular advertising agency he should go through the agreement.

(K) Income Tax : The auditor should verify challans of payment of tax, certificate of tax deducted at source given by the authorities, returns filed by the client, assessment order, counterfoils of cheques issued, bank pass book etc. If tax is deducted at source from the salaries of employees or payment to contractors etc. he should see that it is paid within the time limit.

(L) Sales Tax : Sales tax can be verified with the challans of sales tax, returns filed by the client, assessment order, counterfoils of cheques, bank pass book etc.

(M) Interest Paid : The auditor should verify first the amount of loan outstanding, rate of interest, period etc. from the loan agreement and bank pass book of loan account. Receipts for interest given by the bank or the financial institution should be compared with the entries in the cash book.

In the case of interest on debentures the auditor should verify the rate of interest and the period. He should make actual calculations and verify it with the debenture interest ledger, bank pass book and counterfoils of cheques.

In both the cases, he should see that last year's outstanding interest paid during the year and current years outstanding are rightly recorded in the books.

(N) Legal Expenses : The expenses incurred for filing suits, claims or other legal matters including fees of lawyers or solicitors are called as legal expenses. For vouching of this item, an auditor should verify bills, receipts, counterfoils of cheques issued, bank pass book, correspondence etc. If solicitor is on retainship basis, he should verify the resolution passed in this respect and see his remuneration is properly recorded.

(O) Audit Fees : An auditor should verify the resolution for appointment and remuneration of the auditor or order of the Central Government if he is appointed by the government. He should check the receipt of the auditor, counterfoil of cheque issued, bank pass book and compare the figure with the entry in the cash book.

(P) Repairs : The auditor should check first whether repairs are done departmentally or a contract is given for particular repairs or there is permanent contract for repairs on annual basis. He has to see that the repairs are authorized by the authority and all the formal procedure is completed. He should check the bills of stores and materials purchased, labour charges, engineer's remuneration etc. Compare the figures of receipts and bills and counterfoils of cheques issued with the entries in the cash book. He has to see that any capital expenditure is not shown as revenue expenditure and vice versa.

(Q) Other Expenses : Any other expenses can be vouched with the help of bills, receipts, counterfoils of cheques, bank pass book, correspondence etc. The auditor should take care that the expenditure is related to business and they are properly accounted for.

6. Bills Payables Honoured and Retired : It can be verified with the bills payables, bills payable book, bank pass book, counterfoils of cheques issued and other correspondence. An auditor should see that the honoured bills are cancelled and proper entries are passed in bills payable book.

7. Repayment of Loans and Advances : The auditor should verify the receipts, counterfoils of cheques and bank pass book. It should be confirmed that the payment is as per the agreement, interest element is recorded to interest account and if it is final payment, documents of mortgage and securities are returned by the lender with certificates or letters in this respect.

8. Purchase of Investments : First the auditor should go through the resolution passed in this respect to know the decisions made regarding nature, type amount, period etc. He should see that the investment is as per rules and regulations and it is within the limit. He should check the receipts, counterfoils of cheques, bank pass book, brokers note, allotment letters and other correspondence. He should also check actual investments (share certificates, bonds etc.) and see proper entries (considering ex-dividend / cum-dividend) are passed in the books of accounts.

9. Purchase of Fixed Assets : The auditor should check –

(a) Whether the asset is purchased by executing deed or by lease agreement or by auction or by making direct payment.

(b) Whether all the formal procedures such as registration, paying court fees, preparing ownership papers, affixing stamps and other legal formalities have been completed.

(c) Whether all the expenses related to purchase, acquisition, construction or establishment are treated as capital expenditure.

(d) Agreement / Deed / Contract, Engineers Certificate, Architects Certificate, Auctioneers Certificate, Registration Book (in the case of vehicles), documents of Patents and Copyrights etc.

(e) Receipts, counterfoils of cheques, bank pass book, invoice, insurance policy, challans of taxes paid, bills, correspondence etc. and confirm with the figures and particulars in the cash book.

If the asset is purchased on hire purchase or installment, the auditor should verify the agreement to know the installments, rate of interest, cash price etc. and see that installment and interest are correctly calculated and accounted for. Also see that interest is treated as revenue expenditure.

10. Other Payments and Expenses : According to type of business organization, and nature of business there may be some other payments and expenses such as dividend in the case of company, partners drawings in the case of partnership firm, excise duty & research expenditure in the case of manufacturing concern, preliminary expenses in the case of newly established concern, brokerage or underwriting commission when the company issues shares or debentures so on and so forth. These items can be vouched with the help of receipts, bills, counterfoils of cheques, bank pass book, challans, resolutions passed, agreements, correspondence, dividend warrants issued, brokers note, promoters note, solicitors bills etc. The auditor should not only see that the figures and particulars are correct but also that these are correctly bifurcated in revenue and capital expenditure and properly accounted for.

2.8 Vouching of Credit Purchases and Credit Sales

Vouching of cash transaction is obviously most important one. After completing this auditor should proceed on to audit of credit transactions. These transactions mainly related to credit purchases and credit sales which are recorded in purchase book and sales book. The return of goods is recorded in purchase return book and sales return book.

Purchases and sales are the main activities of any business. So, there is ample number of transactions relating to these. Obviously, chances of misappropriation increases. The main aim of vouching these books is to see that all the goods are recorded and correctly recorded, there is no omission or duplication as well no fraudulent entries are passed.

Before proceeding for vouching of these books, an auditor should examine internal check system regarding credit purchases and sales. If it is defective, he should be more careful.

2.8.1 Vouching of Purchases Book

Before starting the work of vouching an auditor should study the process of credit purchases i.e. how the requisitions are collected, how the supplier is fixed and orders are placed, who signs the order, what are the stages of recording the goods received etc.

While vouching purchase book –

1. An auditor should verify the goods requisition slips, purchase orders, purchase invoices or bills, goods inward notes and goods inward book and verify the figures & particulars with the purchase book.
2. He has to see that only credit purchases are recorded in the purchase book.
3. While verifying purchase invoices he should check that –
   - they are in the name of the client,
   - the date of invoice and date of entry in the purchase book is same and it is related to the period under audit,
   - the goods are not capital goods (assets),
   - the goods are purchased for the business purpose and are dealt with the business of the client,
   - the quantities and their qualities mentioned in the invoices are as per the order placed,
   - the prices mentioned in the invoices are as per the orders or as per the amendments made thereafter having authentic evidences,
   - duties, octroi, freight, carriage, sales tax etc. are charged as per the

orders placed,

- the officer who has checked the invoices has put his full signature marking as ‘Checked’.

4. The procedure of purchases is followed and the responsible officer has authorized the purchase.
5. The amount entered in the purchase book is after adjusting incidental expenses and the trade discount.
6. Purchase order, invoice, goods received note and goods inward register show the same figures and particulars and it tallies with the entries in the purchase book.
7. If columnar purchase book has been maintained, he should also check the entries passed in this book are correct.
8. The auditor should examine carefully that there is no manipulation of account through showing more or less purchase and more or less stock.
9. When the duplicate invoice is produced, he should take careful enquiry about the original invoice and see that it is not produced elsewhere.
10. When officials of the company purchases in the name of the client company for availing the benefits of higher trade discount, see that such purchases are debited to their personal accounts and not to the purchases accounts. Such practice should be discouraged.
11. Purchases of first and last month of a year should be vouched carefully because there is a chance to manipulate accounts by transferring purchase of last year to the current year or vice versa and purchase of current year to next year or vice versa.
12. After checking an invoice, an auditor should tick mark, put initial or put stamp so that it can not be reproduced.
13. He should check the totals and casting of purchase book and related registers.
14. He should prepare a list of missing invoices and call for explanation. If the client failed to produce original or duplicate invoice, he should make a clear note in this regard in his final report

15. Wherever he feels necessary, he should call for confirmation from suppliers directly.

16. He should verify that goods received on consignment or sale or return basis are not recorded in the purchase book.

If the goods received are defective or it is received late or if it is of different quality or type or for any other reasons goods may be returned back to supplier. The auditor should verify that the debit note is prepared accordingly and sent along with the goods returned as well as proper entries are passed in the goods outward register and purchase return book.

2.8.2 Vouching of Sales Book

It is a practice of all business concerns to sale the goods not only for cash but also on credit. Selling the goods on credit is a need of any business; even most of the sales are on credit basis. The main evidence of credit sale is the sales invoices which are prepared by the client himself. So, an auditor should very careful while vouching the credit sales. Before starting vouching he should understand the process of credit sales and who is empowered to make credit sales.

While vouching the sales book an auditor should proceed on the following line.

1. He should first verify date, name of customer, quantity and quality / type of goods, amount of incidental expenses such as duties, taxes, freight, octroi etc. and the total amount from the sales invoice etc. and compare these with the entries in the sales register.

2. He should check calculations, totals and castings of the sales register and daily or weekly or monthly summary.

3. See that the incidental expenses are recorded to respective account. If these are paid on behalf of customers and they will be recovered, they are recorded to customers account.

4. Confirm that only credit sales are recorded in sales register. Sale of assets, investments or other items is not recorded.

5. See that for every sale during the period under audit, invoice is prepared and all invoices are recorded in the sales register. There is no omission or duplication.

6. See that goods sold but not dispatched are not included in closing stock.
7. Verify that there is no fictitious sales are recorded and as well no sales are left unrecorded.
8. Examine that there is no manipulation of accounts through showing higher or less sales and showing higher or less closing stock.
9. Check carefully sales at the beginning and at the end of the year because, there is a chance of manipulation of accounts e.g. to increase profit, fictitious sales may be recorded at the end of a year and they are reversed at the beginning of the next year showing as sales returns.
10. See that the invoices cancelled are not thrown out or destroyed but they are kept marking as ‘Cancelled’.
11. Verify that rate of trade discount is as per the policy of the business. He should enquire in detail if high or low rate of discount is allowed to particular customers.
12. Sales to sister concerns and the companies where the directors are interested should be checked very carefully.
13. Verify all the vouchers related to the credit sales such as orders received, correspondence, sales invoice, goods outward & package register, transport receipts for expenses etc. with the sales book.
14. Wherever necessary he should call for confirmation of debtors directly to him.
15. See that goods sent on consignment and on sale or return basis are not included in credit sales.
16. If there are any alterations or erasures, see that they are initialed and authenticated by the responsible officer.

The auditor should verify also the goods returned by customers for one or other reasons. He should examine the credit note sent to customer by checking name, particulars of goods returned, amount and calculations, signature etc. He should also compare credit notes issued and debit notes received with the entries passed in sales return book. He should verify correspondence in this regard and also check entries in the gate keeper’s book, goods inward register and stock book.

As the vouching is the backbone of auditing, an auditor should take utmost care while vouching the transactions. He should verify as much documents of evidence as possible and exercise his all skills, techniques and knowledge for the purpose.

2.9 Investigation

2.9.1 Meaning of Investigation:

Investigation is a systematic examination and an in-depth inquiry into the accounts and records of an organization for a special purpose. It is an examination of the books of accounts of a business to know its financial position, earning capacity or ascertaining the reasons for losses etc. An investigation implies something more than the verification of the accuracy of figures of the balance sheet. In an investigation, examination is intensive as well as exhaustive so far as the activities or area of accounting under investigation is concerned. In short, the term investigation may be described as *special audit* with a limited or extended scope according to the purpose for which it is conducted. It is always carried out with the object of establishing a fact or obtaining information of a particular nature required by a client.

Eric Kohler in "A Dictionary for Accountants" defines investigation as "An examination of books and records preliminary to financing or for any specified purpose, sometimes differing in scope from the ordinary audit".

Taylor and Perry have defined "Investigation involves inquiry into facts behind the books and accounts, into the technical, financial and the economic position of the business or organization".

The scope of investigation is quite different from that of audit. It is, therefore, an inquiry which may go beyond the books of account of the concern. It may involve an inquiry into technical and financial spheres. Investigation is carried out with the main objective of ascertaining some specific information concerning some or all the phases of business activities. Though, the investigation is mainly concerned with the accounting records of the business, yet other areas are not outside the scope.

Investigation is neither accounting not auditing but a special inquiry with certain objectives. Investigation is thus different from audit. It is a kind of special examination not for the purpose of audit but for some other specified purpose. The auditor conducting an investigation may have to take the help of engineers, lawyers, etc., so that there is an effective investigation. As a matter of fact, an investigation means to inquiry into details and then relates the causes with findings.

Investigation may be carried out on behalf of the proprietors where they suspect any fraud, or by the Central Government at the instance of the shareholders or court.

Accounts of a Joint Stock Company must be audited according to law while investigation is not compulsory.

The investigator should obtain in writing from his client, clear instructions in respect of object of investigation, period to be covered for which investigation is to be made, scope or limits to the extent of inquiry of investigation. The investigator must take due care the interest of his client on whose behalf he has undertaken the work of investigation. The investigator should immediately prepare his report in clear language. It is noted that, there is no specific or prescribed form for the report of an investigation. The report of the investigator is sent to the party which appointed him for the purpose of investigation. The report of investigator is in detail and refers to the instructions given to him, the method of approach, the work carried out, the documents relied upon, and his findings and often his recommendations to the client.

The purpose of investigation may be anything and may vary case to case. There is no fixed objective of an investigation in general. Hence, the scope and objectives of investigation differ from the scope and objectives of auditing. Investigation is carried out not in substitution of audit, but in addition to audit. The investigator may even have to investigate the audited accounts.

2.9.2 Need of Investigation:

Following are the certain circumstances for which investigations are needed:

1. Investigation is needed to an incoming partner, who wants to know the earning capacity of the firm, the financial position of the concern and whether it is advisable to become a partner.
2. Investigation is needed to an individual, partnership firm or a Joint Stock Company which wishes to purchase a private running business in order to ascertain the financial position and the earning capacity of the concern proposed to be taken over.
3. Investigation is to be carried out on behalf of a client who wishes to lend money to a concern to know its financial position.
4. Investigation is needed where fraud is suspected by the proprietor.
5. Need of investigation arises to a prospective shareholder who wishes to purchase shares of a company.
6. Investigation is to be conducted on behalf of the company or an individual for alleged negligence or lack of skill by the auditor, managing director or manager etc.

7. Investigation is needed for ascertaining the reasons for a considerable fall in the gross profit of a manufacturing company.
8. Investigation is to be carried out on behalf of the liquidator of a company where the directors are suspected of fraud or misfeasance.
9. Investigations under the Companies Act- There are provisions in law where the shareholders, creditors, registrar of Joint Stock Companies and Central Government may get the affairs of the companies investigated.
10. Investigation is needed for the sale of business or merger of the business.
11. Investigation is carried out for claims under an insurance policy covering consequential losses.
12. Investigation is needed to ascertain the amount of compensation payable on the compulsory removal of business.
13. Investigation is helpful to beneficiaries where trustees are suspected of fraud or misappropriation.
14. Investigation ordered by the Central Government for various reasons and investigator appointed by the Central Government to investigate related matter.
15. Investigation is needed to Income Tax Authorities for tax liability or detection of undisclosed income.

2.10 Introduction of Verification

Vouching examine correctness of the entries passed in the books of accounts by verifying documentary evidences available in support of the transactions. But this is not sufficient for assets and liabilities. Because vouching does not prove that the asset or liability was actually exist on the date of balance sheet and the valuation shown was correct. For example, vouchers can prove that a car is purchased on a particular date during the year but they can not prove that the car was in existence and in the possession of the client on the date of balance sheet with the given value. It may break, it may lose, it may not have the same value, so on and so forth. Existence of the car can be proved only by physical check up and verifying its value.

Unless checking physical existence and values of assets and liabilities, an auditor can not certify that the balance sheet is showing true and fair view of its state of affairs.

2.10.1 Meaning of Verification

Verification means to confirm or substantiate the truth or accuracy by competent examination. An auditor satisfy himself by documentary evidence or by physical check that the asset is in existence, it is in the possession of the client and the value shown in the balance sheet is proper. This work of auditor is called as verification of assets.

Definitions :

1. Spicer and Pegler : 'The verification of assets implies and inquiry into the value, ownership and title, existence and possession, the presence of any charge on the asset'.

2. J. R. Botliboi : ' In verification of assets the auditor must satisfy himself that they really existed on the date of balance sheet and were free from any charge and they have been properly valued. In verifying the liabilities, he has to see that all liabilities have been inserted at their proper figures and that no liability has been omitted'.

From the above discussion and definitions, we can say that verification involves the following considerations –

(i) that each asset or liability is clearly and properly disclosed and described,

(ii) that the assets and liabilities were actually exist on the date of balance sheet,

(iii) that the ownership and possession of the assets are of the business,

(iv) that the assets are free from any charge and if there is any charge it is specifically mentioned,

(v) that the assets and liabilities are correctly valued and recorded with proper figures.

2.10.2 Objectives of Verification

1. To see that assets and liabilities are valued on the basis of generally accepted accounting principles and the principles are applied consistently.
2. To verify that all the business assets and liabilities are shown in the balance sheet at their right value.
3. To check that the assets and liabilities shown are actually exist.

4. To check that the ownership and possession of the assets are with the organization. If there is any charge, it is shown clearly.
5. To verify that all the assets and liabilities are properly shown in the balance sheet according to the provisions of the respective act, rules and requirements of the business organization.
6. To verify that balance sheet shows true and fair view of the state of affairs of the business.

2.10.3 Significance of Verification

1. It verifies physical existence of the assets and genuineness of liabilities.
2. Any fraud or irregularity regarding assets or liabilities can be detected by verification.
3. Any mortgage, pledge, hypothecation or floating charge on any asset comes to light by verification.
4. Share holders can know the true and fair value of assets and liabilities.
5. Third parties such as creditors, financer, investors etc. can know the real worth of the business.
6. The auditor can state confidently in his report that the balance sheet shows true & fair view of the state of affairs of the business.

2.10.4 Auditor's Position Regarding Verification

Verification is very important duty of an auditor. When an auditor has to report whether the balance sheet shows a true and fair view of the state of affairs of the business concern, he is supposed to take verification of the assets and liabilities. If he proved negligent in this respect, he will be held guilty and responsible for damages.

In the case of London Oil Storage Co. Ltd. Vs. Seear, Hasluck & co., it is stated – 'It is the duty of the auditor to verify the existence of assets stated in the balance sheet and he will be liable for any damage suffered by the client if he fails in his duty'.

In the case of the Kingstone Cotton Mill Co. Ltd., it was held that, it was not the duty of the auditor to take stock. It was also held that if he accepted the certificate of a responsible official in the absence of suspicious circumstances, he was not guilty of negligence.

The judgments observed- 'It is no part of the auditor's duty to take stock. No one contends that it is. He must rely on other people for details of the stock-in-trade in hand'.

‘He is a watchdog, but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest and to rely upon their representations, provided he takes responsible care. If there is anything calculated to excite suspicious he should probe into the bottom, but in the absence of anything of that kind he is only bound to be reasonably cautious and careful’.

In short, an auditor can rely on other’s certificate only in the healthy environment and not in suspicious circumstances. He should be cautious and careful and exercise reasonable skill. Otherwise it will be held that it is the negligence of the duty.

2.10.5 Difference between Vouching and Verification

Vouching and verification, both are important tools of auditing, but not one and the same. Verification is wide term and it is totally different from vouching. The difference between these two can be briefed as below –

Vouching	Verification
It means verifying the correctness of entries with the help of documentary evidences.	It means examining the existence, ownership, possession and valuation of the assets.
It is carried out with the help of vouchers.	It is carried out with the help of vouchers as well as valuation by experts and physical check up.
It is possible any time during the year.	It is possible only after preparing the balance sheet.
Vouching of asset is done for two times– when it is purchased and when it is sold.	Verification is done every year.
It does not include verification and valuation of assets.	It includes vouching as well as valuation of assets.
It comes before verification. It is the first step in checking the assets.	It comes after the vouching. It is the next step in checking assets.

2.11 Meaning of Valuation

Valuation is not merely the determination of the values of the assets as appearing in the balance sheet but is also the critical examination of these values on the basis of normally accepted accounting principles. (V H Kishnadwala, N H Kisnadwalla and M V Shetti)

The balance sheet will show true and fair view if the assets and liabilities are shown with proper values. But the question is which value is proper one. The valuation and the basis of valuation differ according to nature and type of asset and purpose of valuation. An auditor should try to get the answer of the following questions –

(a) What is and what should be the value?,

(b) What is and what should be the basis of valuation?,

(c) What method of valuation is applied and should be applied?,

(d) Whether generally accepted accounting principle are applied or not?,

(e) Whether the valuation is based on established practices of business or not?,

(f) Whether the business is applying the same method and basis for valuation from earlier years or it is changing its policy year to year, etc.

2.11.1 The basis for Valuation

The various values used for the valuation of various assets are –

1. Cost Price : The price which is paid for acquiring the asset including incidental and installation charges.

2. Market Price : The current market price of the particular asset on the date of valuation (the date of balance sheet).

3. Replacement Value : The value which would be necessary to acquire of the same type of asset to replace the existing asset. It also includes incidental and installation charges.

4. Realisable Value : The price which the existing asset, in the existing conditions, would fetch if sold on the date of valuation, excluding charges for realization.

5. Break up Value / Scrap Value : The price which would be realized if the asset is sold as scrap.

6. Book Value : The value at which the asset appears in the balance sheet *i. e.* cost price minus depreciation.

2.11.2 Valuation of Assets

Valuation of assets depends upon the nature of the asset. Different methods of valuation are used for valuation of different types of assets.

2.11.2.1 Valuation of Fixed Assets

Institute of Chartered Accounts of India stated that 'fixed assets are those which are acquired for the purpose of use in the business with the object of earning revenue and which are not intended for resale at a profit and conversion into cash in the ordinary course of business'.

According to De Paula 'fixed assets are those assets of a permanent nature which are acquired by an undertaking with a view to earning profits for a period of years by the use of them and such assets are not held for the purpose of resale'.

These assets can be classified in four categories –

(a) Fixed assets which may be written off over a period of time *e. g.* Patents,

(b) Fixed assets which are not subject to depreciation or depletion *e.g.* Land,

(c) Fixed assets which are subject to depreciation *e.g.* Building, Plant & Machinery,

(d) Fixed assets which are subject to depletion *e.g.* Mines, Coalfields, Oil wells.

2.11.2.2 Valuation of Intangible Fixed Assets

The assets which can neither be seen nor touched but they are valuable to the business and which can be bought or sold are called as Intangible Fixed Asset. For example goodwill, patents and trade marks, copyrights, technical know-how, tenancy rights etc.

These assets are attached to the business and they go with the business. If there is no business they will have no value. The benefits of such assets are spread over a period of time.

Normally intangible assets are valued at cost. (a) If the asset is self generating, the expenditure incurred for bringing the asset into existence would be considered as cost. (b) If the asset is purchased, expenditure incurred for the acquisition of the asset would be considered as cost.

Generally, proper amount is written off every year. If the asset is having particular legal term or validity period or a period of lease, the value of such asset should be written off by spreading the amount over the period.

2.11.2.3 Valuation of Wasting Fixed Assets

The value of such asset goes on decreasing (depletion) due to extraction of materials there from e.g. mines, quarries, coalfields, oil wells etc. Extracting minerals from mine, stones from quarry, oils from well etc. reduce the quantities in the mine, quarry, well etc. So, it is called as wasting assets. In other words, continuous operation of extracting materials leads to gradual decrease in the value. If there is no extraction, there will be no depletion.

Generally such assets are valued at original cost less depletion on the basis of estimated exhaustion or extraction from such assts. However, it is not easy to estimate correctly that to what extent the material is extracted and to what extent it is still left in that.

2.11.2.4 Valuation of Tangible Fixed Assets

There are two methods regarding valuation of tangible fixed assets.

(a) Book Value Method : It is a traditional method. The justification or arguments in favour of book value are -

(i) Any change in the value of the fixed assets does not directly benefit or loss the business.

(ii) Any change in the value of the assets does not increase or decrease the earning capacity of the asset.

(iii) These assets are not meant for resale.

(iv) It is very difficult to determine replacement value of each of the fixed assets.

(v) If the assets are revalued every year by replacement value method, there will be problem for charging depreciation.

(vi) According to 'going concern concept' book value is the most suitable value.

(vii) Increase in the value of asset may unduly inflate the profit and vice versa (if it is shown as profit or loss on revaluation). There will be problem of recording increase or decrease in the value of asset because it is not actual profit or loss.

(b) Replacement Value Method : It is modern trend. Because of general inflationary trend, it is contended that fixed assets should be valued at replacement value. The justification given in support of this is –

(i) Due to inflationary trend book value will not show the true value of the asset. Ultimately balance sheet will not reflect true and fair view of the financial position.

(ii) Replacement value will give the correct idea about the true worth of the investment in fixed assets.

(iii) If the assets are valued on the basis of book value and charged depreciation accordingly, the funds from depreciation may not be adequate to replace the asset when the old asset will become obsolete.

(iv) In the inflationary state, if depreciation is charged on original cost of the asset, due to lower depreciation, the profit will show unduly inflated amount, which may create unrest in the minds of consumers, labour and even the government.

On this ground of difference of opinions the council of the Institute of Chartered Accounts in England and Wales, has recommended that –

(i) The historical cost (book value) should continue to be used for the valuation of fixed assets.

(ii) Any additional amount set aside considering the change in the purchasing power of money (generally inflationary trend) should be treated as a capital reserve and it should not be made available for distribution.

(iii) Fixed assets should not be written up in the balance sheet even though the replacement value is higher than the book value.

(iv) There should clear mention in the final accounts and report of directors that due to inflationary trend, current depreciation fund is inadequate and hence additional amount is set aside for replacement of assets.

2.11.2.5 Valuation of Current/Floating/Circulating Assets

The assets which are produced or created in the normal course of business or which are purchased for resale are called as current assets. Such assets are held temporarily and they can be converted into cash readily and easily. The amount and quantity of these assets change frequently in the normal day to day operations of the business. Stock, cash and bank balance, debtors, stores, bills receivables etc. are the illustrations of floating assets.

Different current assets are valued by different ways as indicated in the chart given below.

To follow one of the basic principles i.e. principle of conservatism, some current assets are valued at cost or market value whichever is lower. Auditor should be alert while valuing current assets because there is higher chance of manipulation of accounts.

Asset	Value
Cash and bank balance	Actual amount
Debtors and bills receivables	Realisable value
Stock of raw materials, work in progress and stores	Cost price
Stock of finished goods, bearer securities and short term investments	Cost or market value whichever is lower
Prepaid expenses	Book value

2.11.2.6 Valuation of Fictitious Assets

In fact fictitious assets are not the assets but they are deferred revenue expenses, to be written off during a particular period of time. For example, preliminary expenses, discount on issue of shares and debentures, expenses on advertisement campaign etc. As these accounts have unwritten debit balances, they are shown as assets under the heading 'Miscellaneous Expenditures' on the asset side of the balance sheet. A portion of such expenditure is written off by debiting to the profit & loss account and the balance is shown as asset. Thus, the value of such assets is equal to total expenditure incurred minus amount written off.

2.11.3 Difference between Verification and Valuation

Verification includes valuation of assets but there is difference between these two which can be stated in brief as under –

Verification	Valuation
It means checking existence, ownership, possession, valuation and charge on the assets.	It means determining the proper value of assets and liabilities.
There is no fixed method for verification. It changes according to nature and type of assets and liabilities.	There is some basis for valuation. Different assets are valued on suitable basis.
It is not possible to get a certificate of verification from any authority. It should be done by the auditor himself.	The auditor can get and rely on the certificate of valuation from the responsible officer or authority.
It is a wide term. It includes vouching.	It is related only to the value of assets and liabilities and does not include verification.
It is not possible without valuation.	It precedes the verification. In general it is the first step in verification.
It is a guard against improper valuation.	It provides one basis for verification.

2.11.4 Auditor's Duties in Connection with Valuation

The auditor has to report that the final account gives true & fair views of the profit or loss and state of affairs of the business. Correctness of the final accounts are largely depends upon the correctness of values of assets and liabilities. It means that an auditor should verify the values of assets and liabilities shown in the balance sheet.

The auditor is responsible for valuation of assets and liabilities not only to his client but to the third parties also. In respect of auditors position regarding valuation of assets and liabilities the following important points be noted.

1. The auditor is not a valuer. He is not an expert for valuation of all types of assets and liabilities.
2. He has to verify the value shown in the balance sheet and ascertain that these are fair, reasonable and in accordance with accepted commercial principles.
3. He has to satisfy himself that the assets and liabilities are valued on the basis of normally accepted accounting principles.
4. He can obtain a certificate of valuation from the experts, surveyors, valuers, directors or any other responsible officer wherever necessary. But there also he has to take utmost care and see that the values referred are reasonable, practical and as per accounting principles. He should not accept the valuation blindly but check the valuation with the available documents and evidences.
5. He should examine that principle and basis of valuation of assets are followed consistently for years.
6. He is not expected to give assurance to repay all the losses to the client and to the third parties who relies on the balance sheet certified by him and suffered a loss. However he bound to exercise reasonable care and skill before certify the balance sheet. Where he finds doubts, he should make his own inquires and whatever his observations should be clearly stated in the report.

   In short, he should take every care that will absolve him from the charge of negligence.

2.11.5 Principles of Verification and Valuation of Assets

For the purpose of verification and valuation of assets an auditor should follow the following principles.

1. Verify the internal control system regarding the acquisition, utilization and disposal of the assets.
2. Verify the record (account / ledger / register) maintained by the client for the assets showing quantitative details and situation of the asset.
3. Verify the values of assets shown in the balance sheet as per the ledger accounts / registers.

4. Verify that the accepted accounting principles are followed consistently.
5. Verify the physical existence of the asset.
6. Verify the ownership and title documents of the asset.
7. Verify that the assets are in the possession of the client.
8. Verify the mortgage or lien or charge or encumbrances on the assets.
9. Verify the values of the assets shown in the balance sheet.
10. Verify that the assets are shown properly (under proper heading) in the balance sheet.
11. Verify that assets are acquired for the purpose of business.
12. Verify whether the management has verified the assets and noted accordingly.
13. Verify whether the assets are revalued during the year and the reasons for revaluation.
14. Note down all the observations and findings which should be mention in the report.

2.11.6 Verification and Valuation of Assets and Liabilities

2.11.6.1 Fixed Assets

2.11.6.1.1 Intangible Fixed Assets

These assets can not be seen or touched hence they can not be physically verified. They are inseparable from the business hence can not be mortgaged or hypothecated or will not have any charge.

(**A) Goodwill :** E L Kohler defined goodwill as –

(a) 'The present value of the expected future income in excess of a normal return on the investment in tangible assets; not a recorded amount unless paid for'.

(b) "The excess of the price paid for business as a whole over the book / computed / agreed value of all tangible net assets purchased'. Normally this type of goodwill appears in the books of accounts.

As the goodwill is an intangible asset, its existence can not be physically examined. An auditor should verify the vending contract, in the case of purchase of business and the basis of calculation and actual computation of goodwill, when it is generated by book entries. In the case of partnership firm when the goodwill is created due to admission or retirement of partner, resolution passed by partners should be checked.

The value of goodwill may change year to year. It is not the duty of the auditor to check whether it is shown with smaller or greater value. But he has to see that any heavy revenue expenditure is not capitalized as goodwill. As it is intangible one, there is no question of any charge on the asset. It can not be mortgaged or hypothecated.

Goodwill is not depreciated but it can be amortized or written off gradually from the profit. The auditor should examine whether it is disclosed clearly and adequately in the books of accounts and shown in the balance sheet at cost less amounts written off.

(B) Copyrights : Copyrights are the property of either an author or a publisher in respect of producing or reproducing books or articles. Its value depends upon merit of the book or article. The asset is shown in the balance sheet at cost less amounts written off.

The auditor should examine original document i.e. written agreement as well as the related correspondence. The expenses incurred should be vouched with the help of supporting evidences. If copyrights are more in number, a schedule should be prepared and verify all these one by one.

(C) Patents and Trade Marks : The auditor should verify –

(i) Certificates of Registration, if it is registered in the name of the client,

(ii) A letter of acknowledgement, if it is registered in the name of the nominee,

(iii) Assignment Deed and registration of Assignment Deed, if it is purchased from another person,

(iv) Patents and Trade Mark Register,

(v) The resolution passed and other relevant documents.

He should confirm that these rights are the property of the client and they are not lapsed due to non payment of renewal fees or expiry of term or for any other reason.

The cost of patents can be examined with the help of the invoices and other documents. The entire expenses incidental to purchase of rights, the initial fees for registration, all expenses of creation, generation and registration and all research expenses are capitalized. But renewal fees are treated as revenue expenditure. The auditor should examine all the vouchers in respect of these expenses. If the client is having number of or series of patents & trade marks, the auditor should call for a schedule which will provide all the details.

This asset should be disclosed in the balance sheet at the original cost less depreciation. See that the depreciation provided is adequate. Verify that lapsed rights are not included and the rights are reviewed and revalued wherever necessary.

2.11.6.1.2 Wasting Fixed Assets

Coal mines, stone quarries etc. – Normally such assets are taken as a lease form the government or local authorities. These assets can be verified with the original lease deeds, related documents and the correspondence. If the lease is in the name of a partner, director or any other nominee, a letter of acknowledgement should be verified.

The asset is shown in the balance sheet at its original cost less the total depletion to date. Cost includes all the cost of exploitation, cost of original developments, additional expenses in respect of extension, additional truckage, equipments etc.

2.11.6.1.3 Tangible Fixed Assets

(A) Freehold Land : The auditor should examine- (a) the title deed and purchase deed, b) certificate of the solicitor for the title of the client, (c) if the title deed is with the solicitor or banker, certificate in this respect from them, (d) if the deed is sent for registration a certificate from solicitor or legal advisor in this respect, (e) related documents and correspondence.

He should also call from the management clarification regarding whether the land is mortgaged or any other charge is created. If it is so, he should verify all the documents and correspondence in respect of mortgage or any other charge.

Land is shown to the assets side of the balance sheet under the heading fixed assets with its cost. Cost include the total price paid and incidental expenses such as legal charges, stamp duty etc. The auditor should verify value of the asset shown in the balance sheet with the audited ledger and /or documents of acquisition. No depreciation is charged on such land.

(B) Leasehold Land : The auditor should verify - (a) original lease, (b) certificate of registration, if it is registered, (c) letter of solicitor or the legal advisor in respect of cost and other documents. He should inspect the clauses regarding installments, repairs and insurance. Because for non payment of installment or breeching the clause regarding repairs, the lease may stand cancelled. If the lease is in the name of nominee, he should verify the letter confirming the arrangement.

Though it is a land, it is taken on lease for a specified period hence, the depreciation is charged on such land. The total depreciation is spread over the period of lease and charged every year accordingly. Cost includes original cost and all incidental expenses.

(C) Buildings : For verification of buildings the auditor should verify –

(a) Bills of contractors, architects and others, certificate of architect and related documents if building is constructed,

(b) Title deed and registration certificate of title deed, receipts for payments etc. if the building is purchased,

(c) Certificate from the solicitor or legal advisor regarding title and validity of title deed,

(d) If the title deeds are in the custody of solicitor or legal advisor or banker, certificate from them in this respect,

(e) If the building is mortgaged, certificate of mortgage and possession of title deed,

(f) Lease agreement if the building is taken on lease, a letter of acknowledgement if the lease is in the name of partner / director / nominee, Certificate of registration of lease.

Confirm that there is no breach of contract or clause. For valuation of buildings the auditor should –

(a) See that all expenses on materials, wages, transport etc. have been capitalized when building is constructed.

(b) Vouch the payment made to vendor if the building is purchased.

(c) Check that legal charges, stamp duty, registration charges and all other incidental expenses are capitalized.

(d) Confirm that adequate depreciation is charged. If consolidated value of land & buildings is shown, adequate depreciation is provided on building portion of this consolidated value. The separate values of land and buildings can be verified from certificate from authorized valuer or architect.

(e) See that building is shown in the balance sheet at cost less depreciation.

(D) Plant and Machinery : An auditor should verify the balance of plant and machinery from the ledger accounts. He should examine that a separate account is maintained for each item or part of the machinery in a register which provides all the details such as date of purchase, cost price, incidental charges, additions to & sale out, etc. He should conduct physical verification and check contracts, invoices and other documents for verifying the ownership. He should also check that the plant & machinery is in the possession of the client. If it is in transit or at any other place other than the ordinary place in the prior erection period, obtain the related certificates and documents. He should confirm that whether there is any charge for the purpose of loan. If it is so, all the papers in relation there to should be checked.

The plant & machinery is shown in the balance sheet at cost less depreciation. Cost includes original cost plus all direct and incidental expenses such as transportation, wages, octroi, custom duty, erection charges etc. Erection charges include salary, wages, professional charges, stores, materials, insurance premium paid for the period of erection, interest on borrowed capital for the period till the commencement of production, lodging & boarding, remuneration, traveling and other expenses of foreign technicians and experts etc. The auditor should see that these expenses are capitalized and no revenue expenses are capitalized. Confirm also the addition to and sale of machinery are clearly disclosed and adequate depreciation is charged. When plant & machinery is revalued, he should obtain the certificate and the report of the valuer and check the reasons for revaluation as well as whether the revaluation is correct.

(E) Furniture and Fixtures : The auditor should first check the furniture & fixture register and see that separate accounts are maintained for each item of furniture and it gives full details such as date of purchase, cost, incidental expenses etc. He can verify some of the furniture physically.

When part of the furniture is sold out or discarded, see that it is authorized by responsible officer. Particularly when the furniture is written off on the reason that it was damaged or unrepairable or unserviceable, he should satisfy himself that the situation was such. See that depreciation is charged adequately considering the purchase and sales of furniture during the year and it is valued at original cost less depreciation.

(F) Vehicles : The auditor can verify the vehicles such as motor cars, motor trucks, motor lorries etc. by checking purchase invoices, registers, R T O certificates, insurance policies etc. See that the expenditures on body building of trucks, transport buses, accessories of cars etc. which are of non-recurring nature are capitalized. Adequate depreciation is provided and shown in the balance sheet at cost less depreciation.

If the number of vehicles is more, he should call for a schedule of motor vehicles and check accordingly. If any vehicle is scrapped or sold out during the year, he should check it very carefully and see that it was done only with the authority of a responsible official. Also check that formal procedure is followed and due care is taken before scrapping or disposing.

In case of all other fixed assets verify the registers, invoices and other ownership documents for verification and for valuation see that it is shown at cost less depreciation and adequate depreciation is provided for. Check the assets physically wherever possible.

2.11.6.2 Investments

Generally, the investments are in the form of Government & Trust securities, shares, debentures, bonds, share warrants, bearer bonds etc. To verify the investments an auditor should take the following care.

1. See that they are properly stated and classified in the balance sheet.
2. Determine that they are valued as per normally accepted accounting principles and the valuation is consistent.
3. See that it is the property of the client i.e. securities are in the name of the client. If it is in the name of the nominee, a letter of acknowledgement is available.
4. Verify physically or with evidences the actual existence of the investments. If securities are in the safe custody of bank, certificate from the bank in this respect be verified.
5. See that there is an adequate internal control regarding acquisition, disposal and for accounting the income arising from the investments.
6. Confirm that all the purchase and sale of investments during the year are with the prior permission of the responsible official or authority. Besides he should check brokers note, the bills, receipts etc.

7. Check that bonus shares received are properly accounted for.

8. Ascertain whether there is any charge on the investments for the purpose of loan.

9. Check carefully investments in the shares or debentures of a subsidiary company.

10. See that general investments and investments for particular purpose such as Provident Fund Investments, Debenture Redemption Fund Investments etc. are separately and properly recorded.

There should be a separate register for investments containing separate accounts for each type of investments showing all the details such as cost, market value, rate of interest, dividend, date on which interest or dividend falls due, date of maturity, maturity value etc. The auditor should call for a schedule of investments as on the date of balance sheet giving full details and check one by one. He should also check whether all income arising from the investments is properly accounted or not.

If moneys are paid but scrips are not received, all the evidences and correspondence should be checked very carefully. As the same if the client has applied for the shares and waiting for allotment of shares, he should check all the details regarding the payment. if allotment letter is received but actual shares are not received, he should verify the details from allotment letter and the related correspondence. Confirm that partly paid shares or debentures (if any) are properly accounted for.

Bearer securities such as share warrants, bearer bonds etc. are to be examined physically and if they are deposited in bank for safe custody, certificate from bank giving full particulars should be examined.

Investments are normally shown in the balance sheet at cost and not at market value. Cost includes cost of acquisition, brokerage and other incidental expenses. The purpose for which the investment was made and nature of the business decide the basis for valuation. When the investments are held as fixed assets, they are valued at cost price and when the investments are held as current assets, they are valued at cost price or market price whichever is lower. The auditor can verify the cost price from the broker's note and the amount paid for acquiring the securities. The market value can be verified from the official list published by Stock Exchange, if they are quoted. If the securities are unquoted, the market value should be computed on the basis of balance sheets of companies of which securities are purchased and the rates of dividend of these companies during the last few years.

2.11.6.3 Current Assets

(A) Closing Stock or Inventory : An auditor should be very careful, alert and exercise all his skills and techniques while verifying closing stock because –

(a) There are more chances of frauds. By using accounting techniques and methods, management can easily manipulate the accounts.

(b) Generally stock includes number of items and sub-items and auditor has no technical knowledge of the goods.

(c) Due to lack of time, it is very difficult to count physically and value the stock on hand.

Auditor can not avoid the duty of verifying closing stock. He would be held responsible for errors and frauds if discovered later on. His duties in this regard are –

1. At first he should examine the method of stock taking and method of valuation of stock and see that whether these methods are consistently used or not.

2. Call for list of items in stock and see that they pertain to the business of the client. Confirm that consumable stores, spare parts, loose tools, dead stock items etc. are not included in stock.

3. Check that quality and quantity as per stock sheet tallies with that of as per book records. Also check all the calculations.

4. If the goods are in warehouse check the warehouse certificate in this respect carefully.

5. Check that goods sold but not dispatched are not included in stock and goods purchased but not received are not excluded from the stock.

6. See that goods with consignee, branches and goods sent on sale or return basis are properly valued and included in the closing stock.

7. Check that the goods damaged and destroyed are approved by the responsible official and valued properly.

8. Compare the value and quantity of closing stock with the same figures of the last few years. As the same, compare the amount and rate of gross profit with the same figures of the last few years. Enquiry should be made if the difference is considerable.

9. Obtain a certificate of closing stock duly signed by the general manager / chief executive / managing director.

The closing stock should be valued correctly. Overvaluation of the stock results in the artificial profit and undervaluation results in less profit. Generally the stock is valued at cost price or market price whichever is lower. Cost price includes purchase price and all incidental expenses such as carriage, cartage, octroi, freight etc. If the client is manufacturing concern, closing stock is divided in three categories i.e. stock of raw materials, semi finished goods and finished goods.

(a) Stock of raw materials is valued at cost price. Cost price includes purchase price and all incidental expenses.

(b) Semi finished goods or work in progress is valued at cost of raw materials used plus estimated cost of wages, direct overheads and works on cost. He should check costing records to verify the cost and obtain a certificate from works manager in this respect.

(c) Finished goods are valued at total cost of production i.e. cost of materials plus cost of labour plus cost of overheads. The auditor should examine the cost records to verify the value.

Closing stock includes stock on hand, stock with agents & consignees, stock of goods sent on sale or return basis, stock with branches, goods in transit and goods purchased but not received. So while verifying the stock, he should also examine the statement of agents, consignees and branches regarding the stock. Goods in transit can be checked by verifying date of goods sent by supplier and date of actual receipt, the statement of transport authority giving details of goods accepted for transportation, delivery challans etc.

(B) Sundry Debtors or Book Debts : To verify the asset, an auditor should first verify the debtors' ledger and sales ledger and see that goods returned are properly adjusted. In addition he should examine the following –

1. All the debts are classified in three categories i.e. debts considered good, doubtful and bad. Adequate provision for doubtful debts is created. Bad debts written off are authentic and sanctioned by the responsible official.

2. Debts due by directors and officers of the company and debts due by the firms and companies where director of client company is partner or director.

He should confirm the balances of individual debtors by getting confirmation from the concerned debtors. As well as he should examine the internal control system in respect of collection from debtors.

(C) Bills Receivable : For the verification of bills receivables an auditor should first examine the bills receivable book and see that it is properly maintained, all the entries are passed in correct way and the balance tallies with the amount shown in the balance sheet. Bills receivables in hand should be verified physically and see the details such as name, date of the bill, date of maturity, stamp, amount etc. Also check the total amount of such bills tallies with the amount shown in the balance sheet.

He has to check that bills endorsed and discounted but not matured are properly accounted and contingent liability is shown in the balance sheet for the purpose. Also check doubtful bills, charge created if any and the statement of bills sent for collection. He should see that bills dishonoured are recorded correctly.

(D) Bank Balance or Cash at Bank : Generally bank balance as per cash book and pass book differs due to time lag in encashment of cheques issued & received and expenses & income directly charged or received by bank. An auditor should verify all the items of Bank Reconciliation Statement thoroughly because there are chances of misappropriation. Taking the support of the fact that the bank balance as per the cash book differs from the bank balance as per pass book or statement of bank, cash may be misappropriated skillfully. A fake Bank Reconciliation Statement may be prepared. So, the auditor should be very alert while checking Bank Reconciliation Statement. Make all the necessary enquiries and check all related documents and correspondence.

If there are more than one account with the same bank or more than one bank, all the accounts should be checked carefully and see that all the balances are taken properly. If any account shows overdraft see that it is not adjusted in the debit balance in other accounts but is shown as liability. Fixed deposits with the bank can be verified with the counterfoil of bank challans, certificate of deposit or from statement of bank.

(E) Cash in Hand : An auditor should visit the client on the date of year ending or on very next day or at the earliest and count physically cash in hand and compare it with the cash balance shown in cash book and balance sheet. If different cash books are maintained such as cash book for counter sales, cash book for sales through agents etc. all such cash books as well as petty cash book & main cash book should be verified simultaneously. So that deficit of one account can not be made up from the excess of other accounts. Counting of cash should be done in the presence of cashier and a responsible officer and a note should be prepared accordingly duly signed by all of them. Shortage or excess of cash should be taken seriously.

Generally a ceiling limit is prescribed for balance of cash in hand, the auditor should see that the limit is not crossed and if crossed what are the reasons. For verification cash at branches, auditor should call certificates from auditors of the branches. Cash in transit can be verified with the record, documentary evidences and correspondences. If there are cheques & drafts received but not deposited into bank and cheques drawn but not issued, he should enquire for the same and if not satisfied mention in his report.

2.11.6.4 Fictitious Assets

(A) Preliminary Expenses : Expenses regarding preparation of and printing of the Memorandum and Articles of Association, legal charges, stamp duty, filing fees etc. in respect of registration or incorporation, printing of share certificates and other stationery required for long time, cost of company seal, cost of affixing stamp on share certificates, fees of solicitors etc. are called as preliminary expenses. They are heavy and incurred at the initial period so they are written off gradually from the future profit. Till then it is continued to be shown as an asset at the value to the extent not written off i.e. at cost less amount written off.

An auditor should verify all the expenditure by means of supporting evidences such as printing bills, bills of solicitors, stationery bills, traveling and related expenditure bills etc. He has to use vouching technique. He has to verify basis and amount written off during the year under audit.

(B) Discount on Issue of Shares and Debentures – When shares or debentures are issued at discount, the face value of shares or debentures is credited and discount is debited to Discount on Issue of Shares or Debentures Account. The amount so debited is treated as fictitious asset and written off gradually from future profits. It is shown in the balance sheet at total amount of discount less amount written off.

The auditor can verify the asset by examining prospectus, shares or debentures allotment notes and other relevant documents. He should also verify the basis, rate and amount written off during the year under audit from the resolutions and amount charged to the profit & loss account of this year and to the few previous years.

2.11.6.5 Capital and Reserves

Capital is the prime source of funds for any business concern. The following points are to be considered while verifying capital.

(a) In the case of sole trader verify the amount brought in and the form in which it is brought in as well as his drawings.

(b) In the case of partnership firm, examine partnership deed and verify amount of capital brought in, drawings, interest on capital and the profit sharing ratio.

(c) In the case of limited company examine –

(i) Memorandum and Article of Association,

(ii) Prospectus for issue of shares,

(iii) Resolutions passed for issue of shares,

(iv) Applications, allotment and calls on shares,

(v) Calls-in-advance and Calls-in-arrears,

(vi) Issue of bonus shares and capitalization of reserves,

(vii) Forfeiture and reissue of shares,

(viii) Issue of shares for purchase of business and

(ix) Provision of the Companies Act 1956 in respect of all the above items.

He can verify the amount from the cash book, bank pass book and register of members. Check that proper accounting entries are passed.

Reserves are retained earnings transferred from the profits. Reserves may be of different types e.g. Statutory Reserves, Development Reserves, reserves for particular purpose etc. An auditor should see the Article of the Association to know what types of reserves are authorized to create. He should also check the resolution passed in respect of the reserves from minute book.

The amount can be verified from the account of the reserves and from profit & loss account. Verify additions to and withdrawals from the reserves particularly, creation of transfer to capital reserve and its application.

2.11.6.6 Secured Loans

(A) Secured Loans from Banks and Financial Institutions : The auditor should check the resolution passed for borrowing and agreement with the bank or financial institution. Examine which asset is given as security or whether it is having floating charge, period and mode of repayment, rate of interest etc.

The amount can be verified from the loan account but in addition he should get the confirmation from the concerned bank or financial institution. Verify also that the interest is paid regularly, outstanding amount if any is shown as liability. Check that borrowings from different banks or financial institutions under different schemes giving different securities are shown separately in the balance sheet.

(B) Debentures : Generally debentures are secured. In addition to Article of Association and resolutions passed an auditor should examine prospectus for issue of debentures. Check the total amount, face value, discount or premium, rate of interest, securities offered etc. The amount due can be verified from the debenture register. Also check the procedure fixed for redemption and redemption made during the year. See that interest is paid regularly; provision is made for outstanding interest and shown as liability.

2.11.6.7 Unsecured Loans

For trading or other purposes a business concern may borrow some funds from banks or financial institutions or from others for a short period of time on personal guarantee. Auditor should check resolutions passed for taking loan, loan agreement and other documents. Examine the period, rate of interest, mode of repayment and other conditions. See that interest is paid regularly and if outstanding, shown as a liability. The amount of loan can be verified with the register. In addition he can get confirmation from banks or the lender. It is shown in the balance sheet to the extent it is outstanding.

2.11.6.8 Current Liabilities and Provisions

(A) Trade Creditors : Auditor should call for list of creditors and verify it with the creditors' ledger and purchase ledger. He should ask the client to send a statement of accounts to the creditors and get their confirmations. The amount pending for a long period of time and payment made to long outstanding should be enquired in detail.

(B) Bills Payables : Bills payables can be verified with the bills payables register and other records. If there are number of bills a schedule should be prepared. The total amount should tally with the amount shown in the balance sheet. He should ask to the client to get a certificate from the drawer confirming the amount, period and other conditions. See that bills payable retired and dishonoured are accounted properly.

(C) Outstanding Expenses : Revenue expenses such as rent, salaries, wages, interest etc. which have become due but not paid are called as outstanding expenses. Total recurring expenses must be considered for finding out net profit or loss but for one or the reason some portion of them may remain unpaid. The auditor should verify the particular expenditure account and cash book & pass book to find out the amount of total expenditure and the portion outstanding. Check carefully that the expenditure paid entirely is not shown as outstanding as well as less amount is shown as outstanding than the actual one. He should obtain a certificate from the responsible officer regarding outstanding expenses giving full details such as nature or name of item of expenditure, total amount, unpaid amount, the authority or party to whom the payment is due etc. If there is doubt he can get confirmation from the parties to whom the payment is due.

(D) Provision for Taxation : Taxes on the profit earned by the business concern during the year is payable in that year. A fair estimate of the taxes must be made and provided for. A short or excess provision for taxes can be adjusted when the assessment is completed. An auditor should verify all the calculations regarding estimation of profit and provision for taxation considering the prevailing rates of taxes.

2.12 Self Assessment Questions

1. What is meant by Vouching? What points must be borne in mind while examining the voucher?
2. "Vouching is the essence of Audit". Explain the statement and give essentials of the valid vouchers.
3. "In vouching payments, the auditor does not merely seek proof that money has been paid away" Discuss.
4. What is vouching? Explain the characteristics and objectives of vouching.
5. What is voucher? Give the examples of voucher that you would reject explaining the reasons.
6. How would you vouch the following ?
   (a) Credit purchase
   (b) Dividend received on investment
   (c) Insurance premium
   (d) Payments to creditors
7. As an auditor how would you vouch the following ?
   (a) Interest received on fixed deposits
   (b) Dividend received
   (c) Stock insurance claim received
   (d) Repayments of debentures
   (e) Payment of commission based on net profit
   (f) Payment of salaries and wages

8. How would you vouch the following ?
   (a) Cash sales
   (b) Travelling expenses and allowances
   (c) Receipts from debtors
9. How would you vouch Credit Purchases and Credit Sales?
10. Write Short Notes on
   (a) Objectives of Vouching
   (b) Vouchers
   (c) Auditor and Vouching
   (d) Weed of Investigation
11. What is the object of Verification of Assets? How would you verify the following?
   (a) Cash in Hand.
   (b) Goods sent on Consignment.
   (c) Investments.
12. What is meant by 'Valuation of Assets'? How would you value the following?
   (a) Work-in-progress.
   (b) Sundry Debtors.
   (c) Trade Marks and Patents.
13. How would you as an auditor verify the following? *(Any three)*
   (a) Cash and bank balance.
   (b) Sundry Debtors.
   (c) Provision for Income Tax.
   (d) Unsecured Loans.
14. Give the importance of valuation of Assets and state the accepted principles of valuation of Fixed Assets.
15. What is meant by 'Verification of Assets'? How does it differ from the term 'Valuation of Assets'? State the importance of verification of assets and liabilities.

16. What is meant by 'Verification of Assets and Liabilities ?' How far is an auditor responsible for verification of assets in the balance sheet ?

2.13 Further Readings

1. Contemporary Auditing : Kamal Gupta, Tata McGraw-Hill Publishing Company Ltd., New Delhi.

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Unit - 3

Special Features in respect of Audit of Co-operative Societies, Banks

Structure

3.0 Objectives

The objectives of this unit are to familiarize you with :-

- The Special features in respect of audit of Co-operative societies
- The Special features in respect of audit of Co-operative banks

3.1 Introduction

Co-operation is an activity of the people. It is a self-generated, voluntary and self-sufficient activity The governments had to pass legislation to monitor the activities of the co-operatives mainly with the purpose of safeguarding the interests of all the members.

In Maharashtra the Co-operatives are governed by the Maharashtra Co-operative Societies Act 1960 and supported by Maharashtra Co-operative Societies Rules, 1961.The Registrar of Co-operative Societies makes it compulsory for every Co-operative Society to audit its accounts.

The co-operative banks in India have been playing an important role in the Indian Financial System since last 100 years. Co-operative Banks in India are registered under the Co-operative Societies Act. The co-operative banks are regulated by the RBI and are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965.

3.2 Special Features in respect of Audit of Co-operative Societies

3.2.1 Meaning & Nature

In Maharashtra the Co-operatives are governed by the Maharashtra Co-operative Societies Act 1960 and supported by Maharashtra Co-operative Societies Rules, 1961. Each co-operative should have its own Bye-Laws which are the guiding principles of the co-operative. These Bye-laws have to be approved through a resolution of the Society. These bye-laws can be amended in the General body Meeting of the co-operative. The only condition on the bye-laws is that they should not be contrary to the Maharashtra Co-operative Societies Act, and have to be approved by the Registrar.

A group of ten persons, who reside in the area of operation of the proposed society and are from different families, can join in application for registration of a society. A society with the objects of promoting the economic interests or the general welfare of the members only can be registered. A member has voting rights in election of the Managing Committee and in general meeting of the members. Every member has one vote, irrespective of the total number of shares held by him .Proxy-voting is not allowed.A member can inspect the books of account of the society and obtain its copies.Every Society shall call Annual General Meeting within a period of three months after the date fixed for completing or drawing up of its accounts for the year. The final authority of the society vests in the general body of the society comprising of all the members.

3.2.2 Rules and regulation regarding auditor of Co-operative Society

The audit of the co-operative societies is the statutory duty of the Registrar under section 81 of the Maharashtra Co-operative Societies Act and accordingly he, by himself or through the person authorised on his behalf (e.g. Chartered Accountant, Certified Auditor etc.), audits every society at least once a year. The audit staff of the district, which is now separate from the regular administrative wing, consists of one District Special Auditor, one Functional Special Auditor assisted by necessary number of auditors and sub-auditors. The audit staff in the district is under the administrative control of the Divisional Special Auditor who is a class I officer at the divisional level.

The District Special Auditor makes arrangement for audit of all societies in the district, for which purpose a list of societies at the end of the year is prepared and societies are allotted to different members of audit staff, according to the volume of business and size of the societies. The Act also provides for appointment of certified auditors with necessary qualifications. The societies which can get their accounts audited by certified auditors are notified in the Government Gazette and accordingly, these societies make arrangements to get their accounts audited through the certified auditors from approved panel.

According to Section 81(1)(a) the Registrar has the power to appoint an auditor by an order, only in case of such societies, which have been given financial assistance including guarantee by the State Government , Govt. Undertakings or Financial Institutions from time to time. Section 81(1)(b) of the amendment act provides that the societies other than the societies referred to in clause (a) shall arrange to get their accounts audited, at least once in a year, by an auditor form the panel of auditors maintained by the Registrar, or by a Chartered Accountant

3.2.3 Important Aspect of Co-operative Societies Audit relates to the following

(i) It has to be ascertained in general whether and if so; to what extent the objects for which the society was set up have been fulfilled. The assessment need not be only in terms of profit made. It could also be in terms of benefits given to members. The benefits could be in terms of sales effected at lower prices to members, economy achieved in operations, avoidance of wastage of funds, avoidance of middlemen in purchases etc.

(ii) Infringement of the provisions of the Act and Rules and the bye-laws of the society, if any, should be pointed out in audit. Financial implications of the infringement should also be assessed and indicated.

(iii) This is necessary in Co-operative Societies in order to ensure that books of accounts are free from manipulation, since in many Rural and Agricultural Societies a considerable number of members could be illiterate and as such personal verification provides a safeguard against any manipulation. Personal verification will however be on the basis of a test check.

(iv) Examination of overdue debts, if any, verification of the cash balance and securities, a valuation of the assets and liabilities and an examination of the working and the other prescribed particulars of the society.

(v) Verification of the balances at the credit of the depositors and creditors, and of the amounts due by the society's debtors, of such proportion thereof as may be fixed

(vi) An examination of the transactions of the members of its committee.

(vii) An examination of the statement of accounts of the society to be prepared by the committee in such form as may be determined

(viii) Certification of the profits actually realised or loss actually incurred in accordance with the procedure prescribed

(ix) Any other matter that may be directed by the Registrar.

3.2.4 Important points to be considered by co-operative auditor

(i) It is the duty of the auditor to verify the cash balance and securities, examine the overdue debts, if any, value assets and liabilities of the society, verify balances at the credit of the depositors and creditors and the amount due by the society's debtors

(ii) The Auditor should satisfy himself that the Co-operative Society has kept all account books and registers (e.g. register of shares, register of members, minute books etc.) in connection with the business of the society as required by the Registrar

(iii) The accounts have been prepared by the Co-operative Society for each separate year in such form as specified by the Act

(iv) Verify whether the provisions of all the bye-laws have been strictly observed and the bye-laws are in accordance with the provisions of the Act and Rules framed there under.

(v) Among other things he should verify for example:

   (a) In respect of Credit Societies whether loans have been sanctioned for proper objects and periods and on adequate security as per conditions applicable to grant of such loans to proper persons. He has also to examine the repayments in order to ascertain book adjustments, improper renewals etc., and examine whether prompt action has been taken for recovery of dues and over dues.

   (b) In respect of marketing societies whether the society has undertaken pooling and grading before sale of produce of members etc.

(c) In respect of other societies whether the business of the society has been conducted according to the Co-operative principles and sound business practices.

(vi) The auditor should verify that at least 25% of the profit is transferred to reserve fund and 10% to welfare fund. The auditor should also see that the dividends paid to members do not exceed 9%.

(vii) Verify genuineness and adequacy of securities, mortgage and other bonds, adequacy of provision made for depreciation of assets and other items of expenses including interest payable on borrowings and deposits.

(viii) (a) Conduct personal verification of members accounts and examination of their pass books with a view to preventing manipulation of accounts by dishonest employees and office bearers.

(b) Verify whether investments of funds made are in accordance with provisions of Act.

(ix) Analyse the reasons for losses incurred by the society and assess after careful examination, deficiency or loss, if any, arising out of negligence or misconduct on the part of any employee or member of the committee, or of the society and after giving due opportunity to the persons whose actions are likely to be adversely commented upon in the Audit Report to explain why responsibility should not be fixed on them for the said deficiency or loss.

(x) Certify the balance sheet subject to qualifications if any indicating the state of Accounts and Affairs of the society and award audit classification to the societies.

(xi) It is the duty of the auditor to submit the audit report to the society and Registrar, expressing his opinion on the Profit & Loss Account, and Balance Sheet of the Society. On completion of audit the auditor shall discuss the report with the member of Managing Committee and may also give his explanatory observation in the General Meeting if he is invited to attend the General Meeting to offer his comments.

In general the Auditor's examination of accounts and affairs of the society should be such as to enable him to certify that the balance sheet of the society exhibits a true and fair view of the affairs of the society at the end of the year and the profit or loss for the financial year ended on that date. The auditor should always be kind and courteous in his relations with both officials and non-officials. His reports should be couched in polite, courteous and clear language. He should act without fear or favour.

3.3 Special Features in respect of Audit of Banks

Co-operative Banks are registered under the Co-operative Societies Act. The co-operative banks are regulated by the RBI and are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965.

I. Meaning and Nature

The Co-operative Societies Act define a Co-operative Bank as a society registered under the Act and doing the business of banking as defined in Clause (b) of Sub-Section (1) 5 of the Banking Regulation Act,1949.It is a Co-operative, registered as a co-operative bank whose members are of similar occupation or profession or who are employed by a common employer or who are employed within the same business district; or have common membership in an association or organisation, including religious, social, co-operative, labour, business or educational groups; or resides within the same defined community or geographical area.

II. Objective & Coverage of Bank Audit

(a) Objective : The main purpose of audit is to ensure that banks balance sheet and profit and loss account reflect a true and fair view of the state of its affairs and profit or loss for the period.

(b) Coverage : The areas to be covered by the audit are as under

- (i) Statements of accounts, Trial balance, Profit & Loss Accounts, Balance Sheet and other financial statements.
- (ii) Balancing of books.
- (iii) Inter-branch and inter-bank reconciliation.
- (iv) Bills payable.
- (v) Revenue expenditure audit.
- (vi) Investment operations.
- (vii) Lending and borrowings.
- (viii) CRR/SLR compliance and correction & compilation of DTL (Demand & Time liabilities) for statutory purposes.

(ix) Monitoring of large advances.

(No advances should normally be sanctioned beyond the discretionary powers of the Officer concerned viz. Branch Manager. C.E.O., other Executives and Chairman and also without proper credit appraisal of the proposal. Board of Directors of Banks should fix limit to sanction of advances by the Officers of the Bank).

(x) Observances of income recognition, asset classification and provisioning norms.

(xi) Documentations.

(xii) Frauds, misappropriation, embezzlement, follow up advances in litigation.

(xiii) Profitability, loss incurring branches.

(xiv) Accuracy and timeliness in compilation of returns submitted to RBI, NABARD and Govt. directives/instructions.

The audit of Co-operative Bank is a much more detailed affair than a audit of a commercial bank, because the internal check system is not likely to be very efficient in case of the Co-operative Banks.

III. The Auditor of the Co-operative Banks should consider the following aspects –

1. The banks should introduce a sound system of internal audit. With a view to Strengthening the credibility of the inspection system in detecting cases of Frauds/malpractices.

2. Verify cash transactions with particular reference to any abnormal receipts and Payments. Vouching Cash in hand by actual counting and comparing with the cashbook Also see the accounting of inward and outward cash remittances. Verify certificates for cash with RBI.

3. Vouch the receipt of cash on account of deposits with the cash book, counterfoils of the receipt book and compare them with the relative accounts.

4. Ensure that in respect of purchase and sale of securities, the branch has acted within its delegated power having regard to its Head Office instructions.
5. Ensure that the securities held in the books of the branch are physically held by it. Also see that the branch is complying with the RBI/Head Office/ Board guidelines regarding documentation and accounting
6. Check the transactions about deposits received and repaid. Percentage check of interest paid on deposits may be made, including calculation of interest on large deposits.
7. Check new accounts opened. Operations in new Current/SB accounts may be verified in the initial period itself to see whether there are any unusual operations. Also examine whether the formalities connected with the opening of new accounts have been followed as per RBI instructions.
8. Ensure that loans and advances have been sanctioned properly (i.e. after due scrutiny and at the appropriate level).Verify whether the sanctions are in accordance with delegated authority.
9. The Auditor should examine the loan policy and procedure, system of credit appraisal, Post-credit supervision, documentation, concentration of loans and advances, advances to directors & their relatives
10. Ensure that securities and documents have been received and properly charged/registered. Also ensure the post disbursement, supervision and follow-up is proper, such as receipt of stock statement, installments, renewal of limits, etc.
11. Verify whether there is any misutilisation of the loans and advances and whether there are instances indicative of diversion of funds. Check whether the letters of credit issued by the branch are within the delegated power and ensure that they are for genuine trade transactions.
12. Check the bank guarantees issued, whether they have been properly and recorded in the register of the bank. Whether they have been promptly renewed on the due dates.
13. Ensure proper follow-up of overdue bills of exchange. Verify whether the classification of advances has been done as per RBI guidelines.

14. Ensure that the maintenance and balancing of accounts, Ledgers and registers Including cash book and general ledger

15. To see accounting of accrued interest is done as per RBI guidelines.

16. Vouch the money borrowed from the Central Co-operative Bank, NABARD/ Other agencies with the cashbook, correspondences and resolution passed by the Managing Committee.

17. Ensure prompt reconciliation of entries outstanding in the inter-branch and interbank Accounts, Suspense Accounts, Sundry Deposits Account, Drafts Accounts, etc

18. To see that accounts are maintained on prudent basis with due adherence to the norms of asset classification, income recognition and provisioning.

19. Carryout a percentage check of calculations of interest, discount, commission and exchange. Check whether debits in income account have been permitted by the competent authorities. Check the transactions of staff accounts. Check cheques returned/bills returned register and look into reasons for return of those instruments.

20. Auditors should examine whether the investments in Government and other approved securities, PSU bonds are as per R. B. I. guidelines.

21. Co-operative banks which have partially / fully computerized their operations should introduce EDP {Electronic Data Processing) audit system on perpetual basis. Duties of system programmer/designer should not be assigned to persons operating the system and there should be separate persons dedicated to system programming/design. System person would only make modifications /improvements to programs and the operating persons would only use such programs without having the right to make any modifications.

AUDITORS REPORT (Specimen)

I/We, the undersigned, Auditor(s) of the ________________________________ Bank Ltd. Report on the Balance Sheet prepared according to Maharashtra Co-operative Societies Act and Banking Regulations Act 1949 as at 31st March, _____

I/We have examined the foregoing Balance Sheet of the _________________ Bank Ltd. as at 31st March, __________ and the profit and Loss Account for the period ended up on that date with the accounts relating thereto of Head of Office and with the returns submitted and certified by the Branch Manager, which returns have been incorporated in the foregoing Balance Sheet and Accounts.

I/We report that:-

i) In my/our opinion, the Balance Sheet is a full and fair one, containing all the necessary particulars and is properly drawn up so as to exhibit a true and correct view of the affairs of the Bank, according to the best of me/us and as shown by the books of the Bank;

ii) where I/we have called for any explanation or information, such explanation and information has been given to me/us and have been found satisfactory;

iii) the transactions of the Bank, which have come to my/our notice, have been within the competence of the Bank;

v) the Returns received from the Branches of the Bank have been found to adequate for the purpose of my/our audit;

v) the Profit & Loss Account shows a true balance of profit for the year covered by such account;

vi) in my/our opinion, the Balance-sheet and the Profit & Loss Account are draw up in conformity with the law, and

vii) in my/our opinion, books of account have been kept by the Bank as required by law.

Place :

Date :

Sd/-

Dept. Auditor/Chartered Accountant.

3.4 Summary

Co-operative Audit (Co-operative Society, Banks etc.) extends somewhat beyond the bare requirements of the Act and should embrace an enquiry into all the circumstances which determine the general position of the society. It is the duty of the Co-operative Auditor to notice any instance in which the Act, rules or byelaws have been infringed, to verify the cash balance and certify the correctness of the accounts, to ascertain that loans are made fairly for proper periods and objects and on adequate security to examine repayments in order to check book adjustments and improper extensions and generally to see that the society is working on sound lines and that the committee, the officers and the ordinary members understand their duties and responsibilities. Apart from the general processes of auditing like vouching, verification of assets and liabilities etc., Co-operative Auditor should see the aspects like Examination of overdue debts, Adherence to Co-operative Principles, Observance of provisions of Act, Rules and bye-laws etc. Co-operative Audit should include scrutiny of the extent of benefit accruing to the weaker sections of the society's members.

3.5 Key Terms

1. **Co-operative Society** : A society which is registered under Maharashtra Co-operative Societies Act 1960

2. **Co-operative Bank** : The Co-operative Societies Act define a Co-operative Bank as a society registered under the Act and doing the business of banking as defined in Clause (b) of Sub-Section (1) 5 of the Banking Regulation Act,1949.

3.6 Self Assessment Questions

(A) Objective type questions

1. Fill in the blanks

(a) Every Co-operative Society in Maharashtra is registered under ....

(b) The audit of the co-operative societies is the statutory duty of the ....

under section 81 of the Maharashtra Co-operative Societies Act.

(c) Co-operative Banks are registered under ....

Ans.: (a) Maharashtra Co-operative Societies Act 1960 (b) Registrar (c) Co-operative Societies Act

2. State whether each of the following statement is True or False

(a) The auditor of a Co-operative Society is appointed by the Registrar of Co-operative Societies.

(b) The auditor should verify that at least 50% of the profit is transferred to reserve fund

(c) The co-operative banks are regulated by the RBI and are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965.

Ans. : (a) True (b) False (c) True,

(B) Explain the points to be considered while carrying out an audit of a Co-operative Banks?

(C) What are the special points to be kept in view while conducting the audit of a Co-operative Society?

3.7 Further Readings

1. Contemporary Auditing : Kamal Gupta.
2. Practical Auditing : B.N.Tandon.
3. Principles & Practice of Auditing : Dinakar Pagare.

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Unit - 4

Company Auditor

Structure

4.0 Objectives

After Studying this unit, you should be able -

- To understand the Role of Company Auditor.
- To know the qualification of an Auditor.
- To know the Disqualifation of an Auditor.
- To explain how the appointment of an Auditor, is made ?
- To know the Remuneration of an Auditor.
- To Explain the Removal of an Auditor
- To know how the Auditor’s Report are prepared
- To Explain Audit & Assurance Standards (AAS- 28)

4.1 Introduction

The business of a Sole trading concern or a Partnership firm is managed by the owners themselves, where as in case of a company the ownership and the management vest in different persons. The shareholders, who are the owners of the company, have no right to take part in the management of business. The affairs of joint stock companies are managed by directors. To ensure that the moneys invested by the shareholders are managed properly. The audit is compulsory under the Companies Act for all types of companies, whether public or private.

According to Sec. 224 of the Companies Act 1956, every company shall appoint an auditor to audit its books of accounts. After the completion of audit, the auditor has to submit his report to the shareholders of the company. The shareholders do not take part in the day to day management of the company. The auditor acts as an agent of the shareholders. The position of the auditor is therefore very vital. He reports to the shareholders about the finances of the company.

4.2 Qualification of an Auditor

[Sec.226 (1); 226(2)]

1. Chartered Accountant : A person is qualified for appointment as the auditor of the company only if he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949. Nationality is not important.

A firm where of all the partners practicing in India are qualified for appointment as auditors, it may be appointed by its firm name to be auditor of a company. In such case, any partner so practicing can act in the name of the firm. However, an individual Chartered Accountant, being sole proprietor (of say, A & Co.) can not be appointed auditor in the name of the firm.

2. Certified Auditors : The holder of a certificate under the Restricted Auditors Certificates (Part 'B' States) Rules 1956 shall be entitled to be appointed as an auditor of companies. Such Certified Auditors are subject to rules framed in this behalf by the Central Government.

4.3 Disqualification of an Auditor

[Sec.226 (3) 226(4) and 226(5)]

The following persons shall not be qualified for appointment as

Auditor of a company.

(i) A body corporate.

(ii) An officer or employee of the company.

(iii) A person who is a partner, or who is in the employment, of an officer or employee of the company.

(iv) A person who is indebted to the company for an amount exceeding one thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees. Indebtedness of up to Rs. 1000 would not be a disqualification.

(v) A person holding any security of the Company which carries Voting rights.

Even if a single partner becomes disqualified under this ground the firm in which he is a partner also becomes disqualified.

Sec. 226(4) A person shall not be qualified for appointment as an auditor of the company if he is, by virtue of the above qualification, disqualified for appointment as an auditor of any other body corporate which is that company's subsidiary or a holding company or a subsidiary of that company's holding company or would be so disqualified if the body corporate were a company.

Sec.226 (5) an auditor, who after his appointment becomes subject to any of the above disqualification, shall be deemed to have vacated his office as an auditor.

The list of disqualification makes the positions of an auditor as in- dependent as possible.

According to second schedule of clause II of the Chartered Accountants Act a professional and practicing Chartered Accountant shall be guilty of a professional misconduct, if he expresses his opinion on the financial statement of any enterprise, in which he or his firm or a partner in his firm or any of his relative have a substantial interest, unless he discloses the interest also in his report.

4.4 Appointment of Auditors

1. Appointment by Shareholders Sec.224 (1)

Every company in each Annual General Meting shall appoint an auditor who shall hold office from the conclusion of that Annual General Meeting till the conclusion of next Annual General Meeting.

The Company has to give information of the appointment to the concerned auditor(s) within seven days of the appointment. The auditor, in turn, on receipt of intimation from the company about his appointment, is required to send a written communication to the concerned Registrar of Companies (ROC) within 30 days of the receipt of the intimation stating whether he has accepted or declined the appointment.

The appointment is valid only from the conclusion of one meeting up to the conclusion of the next meeting. Where an auditor is appointed for any other period, his functioning during the shortened period will not be lawful and he shall not be entitled to any remuneration for the same. But if the next Annual General Meeting is not held within the period prescribed by Section 166, the auditor(s) shall continue to hold office till such meeting is held and concluded. Where such meeting is adjourned to a later date, the auditor(s) shall hold office till the conclusion of the adjourned meeting.

2. Reappointment of Retiring auditor ...... [Sec. 224 (2)]

According to Section 224 (2), at any general meeting, a retiring auditor, by whatsoever authority appointed, shall be reappointed unless—

(a) He is not qualified for reappointment.

(b) He has given the company a notice in writing of his unwillingness to be reappointed.

(c) A resolution has been passed at the meeting appointing somebody else instead of him or providing expressly that he shall not be reappointed; or

(d) Where notice has been given of an intended resolution to appoint some person or persons in place of a retiring auditor, and by reason of death, incapacity or disqualification of that person or of all persons, as the case may be, the resolution can not be proceeded with.

(e) No written certificate has been obtained from the proposed auditor to the effect that the appointment or reappointment, if made will be in according with the limits specified in sub-section (IB) of section 224.

3. Appointment by Central Government ..... [Sec. 224 (3) & (4)]

Where at any Annual General Meeting, no auditors are appointed or reappointed then the power to appoint the auditor would go to Central Government.

Within 7 days of such a meeting where no auditor are appointed the company shall intimate the information to the Central Government who may appoint a person to fill the vacancy. If the company fails to give intimation to the Central Government, the company and every officer in default, shall be punishable with a fine which may extend to Rs. 5000/-

4. Appointment of First Auditor [Sec. 224 (5)]

The first auditors are appointed by the Board of Directors within one month from the date of registration of the company**.**

The auditor so appointed shall hold office until the conclusion of the first Annual General Meeting.

Appointment of the first auditor should be by valid resolution at the Board Meeting. Merely naming them in the articles of association will not be recognized as appointment under the act.

In case the board does not exercises its power in this regard, the first auditors shall be appointed by the company in its general meeting. But whether appointed by the board or by the company, information to the first auditors about the fact of his appointment as such is not a necessary condition.

The First auditors can be removed in General Meeting whether tenure completed or not but nomination notice should be given 14 days before the meeting.

If the board fails to exercise its powers under this subsection then the company in General Meeting shall appoint the first auditors.

5. Appointment in case of casual vacancy [Sec. 224 (6)]

Where a vacancy is caused by the resignation of an auditor, the vacancy shall only be filled by the **company in a General Meeting.**

The Board of Directors may fill any other casual vacancy in the office of an auditor, while any such vacancies continues the remaining auditor or auditors, if any, may continue to act the auditor or auditors. Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting.

The term "Casual Vacancy" has not been defined in the Companies Act. In its natural sense, it means vacancy in the office of auditor resulting from accidental or fortuitous circumstances such as death, incapacity or disqualification of the auditor.

6. Appointment by special resolution (Sec. 224 A)

In case of a company in which **not less than 25% of the subscribed share capital** is held, whether singly or in any combination, by –

(a) A public financial institution, or a government company or the Central Government or any state government, or

(b) Any financial or other institution established by any provincial or State Act, in which a State Government holds not less than 51% of the subscribed share capital, or

(c) A Nationalized bank or an insurance company carrying on general insurance business.

The appointment or reappointment at each general meeting of the company, an auditor or auditors shall be made by a **special resolution.**

If the company fails to pass such a special resolution for making the appointment of an auditor or auditors, it shall be deemed that the auditor or auditors had not been appointed by the company at annual general meeting. In such a case, the Central Government may appoint a person to act as the auditor of the company.

7. Appointment of Auditors of Government Companies (Sec. 619)

Definition of Government Company

Sec. 617 of the Companies Act defines Government Company as a company in which not less than 51% of the paid-up share capital is held by

- Central Government or
- State Government or
- partly by CG and partly by SG and
- includes a company which is subsidiary of a government company

Appointment of auditors in case of a Government Company is subject to the provisions of Sec. 619 which overrides Sec. 224 to Sec. 233 dealing with appointment, etc. of the auditors in the case of non-government companies.

The auditor of a Government Company shall be appointed or reappointed by the Comptroller and Auditor General of India. However the appointment shall be subject to ceiling limits as per Sec. 224 (IB) and (IC).

CEILING ON NUMBER OF AUDITS [Sec. 224 (IB)]

Sec. 224 (IB) introduces a ceiling on the number of companies of which a firm or a person could be the auditor. Accordingly, an auditor cannot hold the audit of companies in excess of the “specified number” of twenty companies, out of which not more than ten companies shall have a paid-up capital of rupees twenty five lakhs or more. In the case of a firm of Chartered Accountants having two or more partners, the specified number shall be counted per partner of the firm, if there are three partners, the firm can hold the audit of 60 companies of which not more than 30 companies shall have a paid-up capital of Rs. 25 lakhs or more. When one person is a partner in more than one firm that person shall be considered only once for the ceiling purposes. Just because he is in more than one firm, he will not be considered more than once. He can hold only upto twenty audits.

No company or its Board of Directors shall appoint or reappoint any person or firm as its auditor if such a person or firm is, at the time of appointment or reappointment, holding appointment as an auditor equal to or more than the “specified number”.

For this purpose

Following audits will not be counted	Following audits will be included
1. Branch audit if doing the head office audit also.	1. Joint audit.
2. Audit of private companies.	2. Sec. 25 company (not for profit companies)
3. Audit of foreign companies.	3. Company Limited by guarantee and having share capital.
4. Special audit u/s 233A.	4. Govt. Company Audit (if appointed by Comptroller and Auditor General).
5. Company Limited by guarantee not having share capital.	5. Cost Audit.
6. Bank audits.	
7. Investigations.	
8. Audit of corporations which are not co. (i.e. Set up by a different act)	
9. Audit of non-corporate bodies.	

Steps to be taken by the Auditor before Accepting the Appointment :-

1. Issuing a certificate that on appointment by the company, the limit on holding of company audit as contemplated under section 224 (IB) will not be exceeded.

2. Ensuring that the requirements of the Section 224 and 225 of the Companies Act have been complied with as discussed below:

(a) If the appointment of the auditor is made for the first time after the incorporation of the company, the auditor should verify whether the Board of Directors has passed resolution for his appointment within one month of date of registration of company.

(b) If the Board of Directors has not appointed the first auditor but the appointment is made by the company in general meeting, the auditor should verify as to whether a proper notice convening the general meeting has been issued by the company and whether the resolution has been validly passed at the general meeting of the company.

(c) If the appointment is being made to fill a causal vacancy the incoming auditor should verify whether the Board of Directors have power to fill causal vacancy and whether Board of Directors have passed resolution filling the causal vacancy.

(d) If the vacancy has a risen due to resignation of auditor, the incoming auditor should see as to whether a proper resolution filling the vacancy has been passed at the General Meeting of the Company.

(e) If the vacancy has arisen as a result of removal of the auditor before the expiry of his term of office, the incoming auditor should see that the proper resolution has been obtained by the company.

(f) If the provision of Section 224 A (Appointment by Special Resolution) apply to the company, the incoming auditor should verify as to whether a special resolution as required under the said Section has been passed.

(g) Where the auditor other than the retiring auditor is proposed to be appointed, the incoming auditor should ascertain whether the provision of Section 225 have been complied with.

3. Communicating with the pervious auditor, if any.

4.5 Auditor's Remuneration [Sec. 224 (8)]

Generally the authority appointing the auditor is authorized to fix his remuneration. There are three such authorities viz.

(1) The Board of Directors has a right to appoint the first auditors and also to fill up the casual vacancies.

(2) The members have a right to appoint auditor every year in the annual general meeting.

(3) If no auditor is appointed at an annual general meeting the Central Government may appoint a person to fill the vacancy.

Hence these authorities will fix up the auditors remuneration.

a. Where appointed by the Board of Directors :-

When an auditor is appointed by the Board of Directors, remuneration is also fixed by them; the resolution appointing the auditor should also prescribe the remuneration. Sometimes, the resolution may empower the Chairman or the Managing Director of the company to fix the remuneration of the auditor.

b. Where appointed by shareholders :-

In this case the remuneration is determined by the shareholders at the AGM. Sometimes, the shareholders may delegate the power of fixing remunerations to the Board of Directors or the Chairman, the Managing Director, etc.

Where a retiring auditor is reappointed and if the resolution does not re-fix his remuneration, the auditor would get the same remuneration as he was previously getting.

c. If appointed by the Central Government :-

In this case the remuneration is fixed by the Central Government

d. If appointed by the Comptroller and Auditor General of India :-

The remuneration shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

e. Remuneration other than audit fees :-

Where an auditor is called upon to render service other than those as an auditor, he is entitled to get extra remuneration for such services, e.g. representing for tax matters, etc. Such remuneration may be fixed by mutual agreement between the auditor and the management.

4.6 REMOVAL OF AUDITOR [Section 224 (5 & 7)]

a) First Auditor(s) :

The first auditor(s) of a company appointed by the Board of Directors prior to the Annual General Meeting may be removed by the members in general meeting. It is immaterial whether or not the auditor(s) has completed his term of appointment. The general meeting may also appoint in his place any other person nominated for the purpose by any member of the company.

b) In other cases :

Any auditor may be removed from office before expiry of his term. But this can be done by the general meeting after obtaining prior approval of the Central Government in this behalf. In the case of the removal of an auditor before the expiry of his term, some provisions of Section 225 relating to the right of the auditor to make representations, to get the representation circulated among shareholders and the right of being orally heard at the general meeting.

Appointment of a new Auditor in place of retiring Auditor :-

According to section 225 (1), a special notice is required for a resolution at an Annual General Meeting appointing as an auditor a person other than a retiring auditor. A special notice is also required for a resolution providing expressly that a retiring auditor shall not be reappointed.

On receipt of such a special notice, the company shall forthwith send its copy to the retiring auditor.

The retiring auditor, on receipt of a copy of such special notice, may make representations in writing to the company. Such representations should not exceed a reasonable length. He may also request the company to circulate his representations to the members of the company. The company must circulate such representations to the members unless the representations are received by the company too late. A notice of the resolution should be given to the members stating also the fact of representations having been made. If a copy of the representation is not sent to the shareholders because they were received too late or because of the default of the company, the auditor may require that the representation shall be read out at the meeting. This will be without prejudice to his right to be heard orally. If the Company Law Board on application either of the company or of any person claiming to be aggrieved, is satisfied that this right has been abused to secured needless publicity for defamatory purposed, copies of representations need not be sent out or read our at the meeting. These provisions shall also apply to the removal of first auditors appointed by the Board of Directors.

When a new auditor is appointed in place of the retiring auditor, the company within seven days of the meeting should intimated to the new auditor about his appointment who in turn should inform the Registrar within one month of the receipt of the intimation, in writing that he has accepted or refused to accept appointment. The new auditor should also communicate in writing to the retiring auditor before accepting the audit. If an auditor accept a position as an auditor previously held by another Chartered Accountant, without first communicating with him in writing it amounts to breach of professional etiquette. Failure to do so constitute a misconduct leading to an enquiry into his conduct by the council of the Institute and, if proved may result in the person declared unfit to continue to be a member of the Institute.

The objective of communicating with the previous auditor is that the member (the auditor) may have an opportunity to know the reasons for change, in order to be able to safeguard his own interest, the legitimate interest of the public and the independence of existing auditors.

4.7 Auditor's Report

Under the provisions of Companies Act (Section 227 (2), the auditor of a company has to examine the accounts and has to submit his report to the shareholders on the accounts audited by him. The auditor is required to report to them that (i) he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and (ii) that the accounts are drawn up in accordance with the requirements of the Companies Act, and (iii) give the information required by the provisions of the Act, and that (iv) the accounts thus drawn up give a true and fair view of the state of affairs the company and they reflect true and fair view of the profit or loss of the company for its financial year.

It is a duty imposed upon the auditor by Section 227 (2) of the Companies Act, to submit such report to the shareholders. The auditor shall makes a report to be members of the company on the accounts examined by him, and on every balance sheet and profit and loss account and on every other document declared by this Act to be part of or annexed to the balance sheet or profit and loss account, which are laid before the company in general meeting during his tenure of office.

Meaning of Audit Report

The report prepared by the auditor after examining the accounts of a company called Audit Report. **Joseph Lancaster** Says, “A report is a statement of collected and considered facts, so drawn up as to give clear and concise information to persons, who are not already in possession of the full facts of the subject matter of the report.”

Importance of Audit Report

Auditor’s report is a statement which is of great value to all those who are connected with the company. It is a summary of the work done by the auditor which may create a favourable or adverse impression on the reader of the account.

Audit Report is the conclusion reached by the auditor after having audited the accounts of a company, in which he concludes, whether in his opinion the accounts give a true and fair view of the state of affairs as well as of the results the company.

1. Importance of Audit Report to the Shareholders.
2. Importance of Audit Report for Directors.
3. Importance of Audit Report for Creditors of the Company.
4. Importance for Debentureholders of the Company.
5. Importance for Investors.
6. Importance for the Government.
7. Importance for Income-Tax Department.

Contents of Audit Report

According to Section 227 (3) the auditor has to state in his report-

- Whether he has obtained all the information and explanation which to the best of his knowledge and belief were necessary for the purpose of audit; and whether according to the information and explanation given to him, the accounts give the information required by the Act.
- Whether in his opinion, proper books of accounts, as required by the law, have been kept by the company, so far as it appears from the examination of those books.
- Proper information for the purposes of audit have been received from the branches not visited by him.
- Whether the company's Balance Sheet and Profit and Loss Account dealt with by report are in agreement with the books of account and returns;
- Whether, in his opinion, Balance Sheet and Profit and Loss Account comply with the accounting standards referred to in subsection (3C) of section 211.
- Whether any director is disqualified from being appointed as director u/s 274 (i) (g).
- Whether any cess payable under section 441.

Types of Audit Reports :-

There are two types of the Report-

(A) Clean Report and (B) Qualified Report.

A] Clean Report

Where the Balance Sheet of a company gives a true and fair view of the state of affairs of the company and Profit and Loss Account give a true and fair view of the profit or loss of the company and where no defect or discrepancy has been found by the auditor during examination of accounts, the auditor gives a clean (unqualified) report.

B] Qualified Report

During the course of auditing the books of account, the auditor requires several explanations in regard to the transactions of a company. Whenever the auditor is not satisfied with any explanation or information furnished to him, or if he otherwise feels that the Balance Sheet and the Profit and Loss Account do not exhibit a true and fair view of the state of affairs of the company and its financial results; he must mention the fact in his report. Such a report is called a **"Qualified Report".** Also, when the auditor is of the opinion that the accounts presented by the directors with their elucidations are not supported by the information; he qualifies his report mentioning therein the factual position.

The auditor should boldly and clearly specify the qualifications in his report to the shareholders. If he fails to do so, he may be held liable for the breach of duty. [Leading case of London And General Bank Ltd. (1895)], the auditor in this case liable to pay damages, because the auditor is not mention the fact clearly about the insufficient securities. The auditor should in his report give a clear and unambiguous statement which can be understood even by a laymen or a casual reader.

Circumstance under which Qualified Audit Report can be given :-

Under the following circumstances, a qualified report can be given by the auditor.

(a) Where the examination of accounts could not be carried on in accordance with the accepted principles of auditing.

(b) Where the auditor is not furnished with the required books of account, vouchers and records or the necessary information for the purpose of audit and explanations are not satisfactorily furnished to him.

(c) Where the accounts and financial statements are not prepared according to generally accepted accounting principles.

(d) Where the profit and Loss Account and Balance Sheet are prepared in a manner which is not in accordance with the requirements of the Companies Act.

(e) Where the books of account are not maintained as required by law.

(f) Where the directors, or managing director work in violation of provisions of the Companies Act or of the regulation of Articles and Memorandum of Association.

(g) Where he is satisfied that the Balance Sheet and Profit and Loss Account fail to give a true and fair view of the state of affairs of the company and of its financial results.

Statutory Report :-

According to section 165 of the Companies Act every company limited by shares, and every company limited by guarantee and having a share capital, shall hold a general meeting of the shareholders within six months but not before one month after the company is entitled to commence business. Such a first general meeting of the shareholders is called the Statutory Meeting.

The Companies Act further lays down in this section that the directors shall forward to the shareholders and the Registrar twenty one days before the holding of the Statutory Meeting, a report, called the **Statutory Report.** This must contain the following :-

1) The number of shares allotted as fully paid and partly paid.

2) The amount received in respect of such shares.

3) The number of shares which have been allotted for consideration other than cash and the consideration thereof.

4) An abstract of cash receipts in respect of shares, debentures and other sources and payments there out up to seven days before the submission of the Statutory Report and the balance in hand on that date.

5) The names and addresses and occupation of the directors, managing agents, auditors, managers and secretary of the company and any changes which might have occurred in the name, addresses etc. since the date of the incorporation of the company.

6) The particulars of contracts which are to be submitted to the shareholders at the meeting for their approval.

7) The extent, if any, to which each underwriting contract, if any, has not been carried out, and the reasons thereof.

8) An account of the commission and brokerage paid or to be paid to any manager, director or agents in connection with the sale or issue of shares or debentures.

9) An account of estimate of Preliminary Expenses.

10) Arrears of calls, if any, due from the directors, managing agents, every partner of the managing agents, the secretaries, treasurers, etc.

The report has to be certified by not less than two directors, one of whom shall be a managing director, if any, and the auditor has to certify as correct the report so far as it relates to the shares allotted by the company, the cash received in respect of such shares and the receipts and payments of the company. Such an audit is termed as Statutory Audit.

The auditor has to give a certificate in connection with the report as follows:

We hereby certify as correct so much of the report as relates to the shares allotted by the company and to the cash received in respect of such shares and to the receipts and payments of the company.

4.8 Audit and Assurance Standards (AAS-28)

(The Auditor's Report on Financial Statements)

1. Objective :-

To establish standards on the form and content of the auditor's report. The SA requires that the auditor should review and assess the conclusions drawn from the audit evidence obtained on the basis for the expression of an opinion in the financial statements.

2. Basic elements of an Auditor's Report :-

(a) Title : It may be appropriate to use the term "Auditor" to distinguish the auditor's report from report issued by others.

(b) Addressee : The auditor's report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations.

(c) Opening or Introductory paragraph : The report should identify the financial statements that have been audited including the data and period covered by the financial statements. The report should include a statement of responsibility of the entity's management and of the auditor.

(d) Scope paragraph : The report should describe the scope of the audit by stating that the audit was conducted in accordance with the auditing standards generally accepted in India. The report should describe the audit as including examining on a test basis, evidence supporting the amounts and disclosures in the financial statements, as also assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statement presentation. The report should include a statement that the audit provides a reasonable basis for opinion.

(**e) Opinion paragraph :** The report should clearly indicate the financial reporting framework used to prepare the financial statements and express an opinion on the true and fair view in accordance with that financial reporting framework and where appropriate the compliance with the statutory and or regulatory requirements.

(f) Date of the report : The report should be dated as of the completion date of the audit, which should not be earlier than the date on which the financial statements are signed or approved by the management.

(g) Place of signature : The report should name the specific location, which is ordinarily the city where the audit report is signed.

(h) Auditor's signature : The report should be signed in the name of the firm, the personal name of the auditor or both as appropriate.

3. Auditor's Report :-

The auditor should incorporate in his report, the matters specified by a statute or regulator and or report in the form prescribed by them in addition to the requirements prescribed above.

An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for preparation and presentation of the financial statements.

The AAS list down the situations in which auditor's report may have to be modified:

- Matters that do not affect the auditor's opinion.
- Matters that do affect the auditor's opinion including qualified opinion, disclaimer of opinion or adverse opinion.

The AAS specifies that in respect of matters that do not affect the auditor's opinion, the auditor should modify the report by adding a paragraph to highlight a material matter regarding a going concern problem which is unresolved or a significant uncertainty the resolution of which is dependent on future events and which may significantly affect the financial statements. In such matters, the opinion paragraph would refer to the fact that the auditor's opinion is not qualified in this respect.

4. Matters that do affect the auditor's opinion :-

The SA specifies that in respect of matters that do affect the auditor's opinion.

(a) A 'qualified opinion' should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with the management is not so material and pervasive as to require a adverse opinion, or limitation on scope is not material and pervasive as to require a disclaimer of opinion.

(b) A 'disclaimer of opinion' should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor is unable to obtain sufficient appropriate audit evidence and is hence unable to express an opinion on the financial statements.

(c) An 'adverse opinion' should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is inadequate to disclose the misleading or incomplete nature of the financial statements.

5. Opinion other than an unqualified opinion :-

Whenever the auditor requires an opinion other than unqualified, a description of all the substantive reasons should be included in the report and quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the report.

6. Limitation on Scope :-

The AAS also requires that in case there is a limitation on scope that requires expression of a qualified opinion or a disclaimer of opinion, the auditor's report should describe the limitation and indicate the possible adjustments that might have been necessary had the limitations not existed.

4.9 Self Assessment Questions

1. Describe qualification & disqualification of an auditor.
2. Explain how the appointment of an auditor is made.
3. Write short notes on the following
   a) Auditor's Remuneration
   b) Removal of Auditor
   c) Statutory Audit Reporting

4.10 Further Readings

1. Contemporary Auditing : Kamal Gupta.
2. Practical Auditing : B. W. Tondon.
2. Principles and Practice of Auditing : R. G. Saxena.
4. Auditing Principles, Practices and Problems : Jagdish Prakash.

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Definitions, Residence & Tax Liability

Structure of Unit

1.0 Objectives

After studying this unit you should be able to understand :

- Meaning of Income-tax.
- Explain the different definitions under Income tax Act.
- To determine the residential status of every person.
- To determine the liability of residential status.

1.1 Introduction

The importance of the income tax has increased considerably in the present days because it has become a major source of revenue to the Government to be utilized for the social and economic development of the country. It is one of the effective instruments of reducing unequal distribution of wealth between the rich and the poor.

1.2 Meaning of Income tax and Levy of Income Tax

Income tax is a tax on income. Every person with an income in excess of a prescribed limit has to pay a tax. Such tax charged on excess income is called Income tax. Income tax is a direct tax. It is contained in the income tax Act 1961. However every year the parliament passes a finance bill which can make amendments to Income tax Act. The rates of income tax for the year are specified in the finance bill (called the budget).

For levy of income tax all the taxable income of a person should be determined as per the provisions of the Act and Rules. The income arising from any of the following heads is chargeable to tax :

i) Income from Salary

ii) Income from House Property

iii) Profits and Gains of Business or Profession.

iv) Capital Gains.

v) Income from Other Sources.

The income of a person should be computed under each head separately. The total of such net amount from each head of income is called the "Gross total Income". There are other permissible deductions under the Act which are to be deducted from the gross total income. The balance is called the taxable income or "Total Income". The incomes which are exempt from tax are not included in the above income.

1.3 Definitions under Income Tax Act

1. Agricultural Income

There are three basic conditions to be fulfilled so that the income can be called agricultural income.

a) The income should be related with land.

b) The land should be situated in India. If the land is situated outside India the Income derived from such land is not agriculture income.

c) The land should be used for agricultural purposes. There should have been some agricultural operations performed on that land.

Following incomes are treated as agricultural income.

a) Any rent or revenue derived, Rent is a receipt in cash or yield or income from land.

b) Income by way of sale of agricultural produce, performance of any process, which makes the produce fit for market.

c) House property income of a building situated on or in immediate vicinity of the land. (Such income from building will not be treated as agricultural income if the land or building is let out for residential purpose or for the purpose of a business or profession.)

The following are not considered as agricultural Income,

a) Income from market, ferries and fisheries.

b) Income from stone quarries.

c) Income from mining royalties.

d) Income arising from supply of water for irrigation purpose.

e) Income from Dairy farming or poultry.

f) Income from sale of earth or brick making.

g) Income from sale of wood of spontaneous forests.

h) Remuneration received from a company engaged in agriculture.

i) If the land is located outside India, any income derived from such land.

Agricultural income is exempt from income tax u/s 10 (i). However if the agricultural income exceeds Rs. 5,000, it is taken into account for determining the rates of income tax on other non agricultural income of an assessee.

2. Assessee

An assessee is a person

a) From whom any tax is payable.

b) From whom any other sum (interest, penalty) is payable.

c) Against whom any proceedings under the Act have been initiated.

d) Who is deemed to be an assessee in default. (a person who has failed to discharge any obligation under the Act.)

3. Assessment Year (A.Y.)

Assessment year means the period of twelve months commencing on the 1^{st} day of April every year and ending on 31^{st} March next following. This is the financial year of the central Government. This is also called “Income tax year”. The income earned in the previous year is brought to tax in the assessment year succeeds the previous year.

4. Previous Year (P.Y.)

The previous year is also known as “Income year” or “Accounting Year”. The income earned in the previous year is taxed in the assessment year. Like the assessment year the previous year also commences on 1^{st} April and ends on 31^{st} March. From the assessment year 1989-90 onwards the financial year i.e. 1^{st} April to 31^{st} March immediately preceding the assessment year is the previous year in respect of all the assessees.

In the case of a business or profession newly setup in the financial year, the period of previous year should be from the date of setting up of the business or profession to 31^{st} March next following. If the business is newly started on 1.6.2014, then the period of previous year will be of 10 months beginning from 1.6.2014 to 31.3.2015 for the assessment year 2015-16. Thereafter it will be from 1^{st} April to 31^{st} March, each year.

5. Income

The income tax Act does not define the term income. However Sec. 2(24) states that income includes the following.

i) Profit and gains

ii) Dividends

iii) Voluntary contributions received by charitable institutions, religious trusts, research associations etc.

iv) The value of any perquisite or profit in lieu of salary taxable under the head ‘Salaries’.

v) Any allowance granted to employees.

vi) Income chargeable as business income u/s 28.

vii) Capital gains u/s 45.

viii) The profits and gains of insurance carried on by mutual insurance company or by a co-operative society, computed in accordance with provisions of this Act u/s 44.

ix) Winning from lotteries, betting, cross-word puzzles, gambling, horse race etc.

x) Employer's contribution to provident fund or super annuation fund.

xi) Any sum recovered in the previous year by the assessee in respect of any loss, expenditure or trading liability which has been allowed as deduction for any year in the past u/s 41 (i).

xii) Any annuity due, or commuted value of any annuity paid u/s 280 D.

xiii) Every other income which is not excluded from the total income and which is chargeable under sec. 56 as income from other sources.

Following are the important points to be noted in respect of income.

a) It is immaterial whether the income earned is legal or illegal.

b) It may be in cash or kind.

c) It is not necessary that the income must be earned regularly.

6. Person

The term 'person' includes :

a) An individual : He is a natural human being and also includes minor, person of unsound mind.

b) A Hindu Undivided Family (HUF) : A Hindu family of persons lineally descendent from a common ancestor and includes their wives and unmarried daughters. A joint family of Christian or Muslim religion can not be called HUF.

c) A Company : It may be Indian company or a foreign company. It includes public as well as Private limited companies.

d) **An Association of Persons (AOP) :** It refers to a body of persons, whether incorporated or not, who have joined together to serve common interest e.g. Trusts, Co-operative societies, Trade Unions etc.

e) **Firm :** It refers to a partnership concern governed by the partnership Act.

f) **A Local Authority :** It is a entity of local governing bodies like municipalities, municipal corporations, grampanchayat, district boards etc.

g) **Every Artificial Juridical Person :** It is residual category. It includes all persons, which are not covered under the above six categories.

7. Company

A company means :

a) An Indian Company.

b) Any body corporate incorporated under the laws of any other country.

c) Any institution which has been assessed as company for any A.Y. before 1970-71.

d) Any institution declared by Central Board of Direct Taxes (CBDT) as a company.

8. Indian Company

Indian company means a company registered under the companies Act 1956. It also includes following, if the registered office of the company or institution is in India.

a) Any company formed and registered under any other company law formerly in force in India.

b) A company established under any Govt. Act.

c) Any institution declared as a company by CBDT u/s 2 (17) given above.

d) A company formed under the laws in force in the state of Jammu & Kashmir and the Union Territories of Dadra, Nagar Haveli, Daman & Div and Pondechery.

9. Business

"Business includes any trade, commerce or manufacture or any adventure in the nature of trade, commerce or manufacture."

Generally, business means any activity carried on for profit. In order to verify whether a transaction involves a business, the following points must be taken into account.

i) Whether the transaction involves the purchase or sale of a commodity or service.

ii) Whether there was any intention of earning profit.

10. Capital Asset

'Capital asset' means property of any kind held by an assessee, whether or not connected with his business or profession. Hence all the movable or immovable property including leasehold rights, partner's share in a firm, a manufacturing right etc. are treated as capital assets. But the following assets held by an assesses are not included in the above definition.

a) Any stock-in-trade, consumable stores or raw materials held for the purpose of his business or profession.

b) Personal effects i.e. movable property or furniture but excluding jewellery held for the personal use by the assessee or any member of his family dependent on him.

c) Agricultural land in India not being situated in an 'Urban area'.

d) Gold bonds issued by the Central Government (Such as 6.5% Gold Bonds, 1977 or 7% Gold Bonds 1980 or National defense Gold Bonds 1980, Special Bearer Bonds 1991 and 3 years IDBI Capital Bonds issued by the central Government.)

11. Casual Income

Any receipt which is of a casual and non-recurring nature including winning from lotteries, cross-word puzzles etc. is a casual income. Casual income would mean the accidental or fortuitous receipts occurring without stipulation contract, calculation or plan. Casual income is not exempt from income tax.

12. Fringe Benefits

'Fringe Benefits' means certain benefits (as stated below) provided by the employer to his employees and an employer is required to pay an additional income tax thereon.

a) Any privilege, service, facility or amenity directly or indirectly provided to employees.

b) Any free or concessional tickets for private journeys of employee or his family members.

c) Any contribution by the employer to the approved superannuation fund of employee.

d) Any free or concessional transport or allotment of securities or sweat equity shares to employees.

1.4 Concept of Residential Status

In Income Tax the concept of residential status is used to determine the tax liability of Indian income and foreign income. It is necessary to determine the residential status of every person and assessee for computation of taxable income. The Act provides different conditions for determining the residential status or various persons like individual, HUF, Firm, Company etc.

Basically the assessee can be either 1. Resident or 2. Non Resident (NR). If the assesses is an Individual or HUF, the resident category is further divided into two sub categories. 1. Resident and Ordinarily Resident (R & OR). 2. Resident but not Ordinarily Resident (RNOR).

Residential Status

- Resident
  - Resident & Ordinarily Resident
  - Resident but Not Ordinarily Resident
  - (For Individual and HUF only.)
- Non Resident

The following are the conditions for determining the residence of an Individuals.

1. Resident in India [Sec. 6(1)]

An Individual is said to be resident in India in any previous year, if he fulfils any of the following two conditions.

i) He is in India in the pervious year for a period of 182 days or more, or

ii) He is in India for a period of 60 days or more during the previous year and 365 days or more during the 4 years preceding the previous year.

Exception to the above condition of at least 60 days stay in India.

1. Any Indian citizen leaving India for employment during a previous year the stay period should be 182 days or more instead of 60 days or more.

2. Any Indian citizen or a person of Indian origin, residing outside India comes to India for a visit; again the stay period should be 182 days or more instead of 60 days or more.

2. Resident and Ordinarily Resident in India [Sec. 6(6)]

If an Individual is a resident in India as stated above and satisfied both the following conditions, he is said to be resident and ordinarily resident in India.

i) He is resident in India at least 9 out of 10 previous years preceding the relevant previous year and

ii) He is in India for a period of 729 days or more during 7 years preceding the relevant previous year.

3. Not Ordinarily Resident

A resident who does not fulfill any of the above two conditions is said to be not ordinarily resident.

4. Non-Resident

If an individual does not satisfy any of the conditions under section 6 (1) and 6 (6) he is said to be the non-resident.

2. Hindu Undivided Family (HUF)

1. Resident : It control and management of its affairs is wholly or partly situated in India, it is said to be resident in India.

2. Resident and Ordinarily Resident : A HUF is said to be ordinarily resident in India if its Karta or Manager is resident in India.

(a) in at least 9 years out of 10 years preceding the relevant previous year and

(b) is in India for 729 days or more during 7 years preceding the relevant previous year.

3. Resident but not ordinarily Resident : If any of the above two conditions is not fulfilled, the HUF is said to be resident but not ordinarily resident in India.

4. Non-Resident : If the control and management of the HUF is situated wholly outside India, the HUF is non-resident.

3. Firm and Association of Persons

A Firm or Association of Persons is said to be 'Resident' in India in any previous year, if the control and management of its affairs is situated in India either wholly or partly in that year.

They are said to be 'Non-Resident' when the control and management of their affairs is situated wholly outside India.

4. Company

Resident : A company is said to be 'Resident' in India in any previous year, if

i) it is an Indian company or

ii) The control and management of its affairs is situated wholly in India, during the previous year.

Every Indian company is treated as 'Resident' in India whether its control and management is situated in India or abroad. But as regards other companies they are treated as resident companies only when the control and management of their affairs is situated wholly in India.

Non-Resident : A company is said to be 'Non-Resident' when it does not satisfy the above mentioned conditions.

(A firm, or association of persons or a company can not be not ordinarily resident. Only individuals and HUF can become "Not-ordinary resident" in addition to resident and non-resident.)

1.5 Tax Liability as per Residential Status

1. Persons who are resident and ordinarily resident are chargeable to tax on all income.

a) Which is received or is deemed to be received in India.

b) Which accrues or arises or is deemed to accrue or arise in India and

c) Which accrues or arises outside India i.e. foreign income.

2. A person who is resident but not ordinarily resident, his tax liability is same as of resident and ordinary resident except that the income which accrues or arises outside India is not included in his total income unless it is derived from a business controlled in or profession set up in India.

3. A person, who is non-resident, he is liable to pay tax an income received or deemed to be received in India, or income accrued or arose or deemed to be accrued or arose in India only. Income accruing or arising outside India of non-resident is not taxable in India even if it is remitted to India.

The tax liability of person is dependent on residential status of a person. The following chart shows the tax liability of various incomes for different residential status.

Types/Description of Income	Resident		
	R & OR	**RNOR**	**Non Resident**
1. Income received in India accruing anywhere else.	Taxable	Taxable	Taxable
2. Income accruing/arising in India received any where else	Taxable	Taxable	Taxable
3. Income deemed to have been received in India.	Taxable	Taxable	Taxable
4. Income deemed to have accrued or arisen in India.	Taxable	Taxable	Taxable
5. Income received and accrued outside India from a business controlled from India or profession setup in India.	Taxable	Taxable	Not Taxable
6. Income received and accrued outside India from a business controlled from outside India or a profession set up outside India. (Foreign Income)	Taxable	Not Taxable	Not Taxable

It means that the Indian income is taxable in India irrespective of the residential status and the foreign income is taxable in case of Resident only.

Income deemed to be received

The following incomes though not actually received are deemed to be received and taxed accordingly.

i) Employer's contribution to recognized Provident Fund in excess of 12% of salary.

ii) Interest credited to the provident fund account exceeding the specified rate per annum. The present rate is 9.5% p.a.

iii) The transferred balance of unrecognized provident fund to a recognized provident fund in the previous year.

iv) Dividend declared or paid by a company and also an interim dividend which is unconditionally made available to the members in the previous year.

v) Tax deducted at source. It might be tax deducted from salary, interest, rent, professional fees etc.

vi) Cash credits and unexplained investments u/s 68 to 69 D. This is generally the undisclosed income.

vii) Deemed profits u/s 4. These are recoveries of earlier allowed bad debts, recoveries from discontinued business.

Income deemed to accrue or arise in India (Sec. 9)

According to sec. 9 following incomes are deemed to accrue or arise in India.

i) Income through a business connection in India.

ii) Income from a property situated in India.

iii) Income from a capital asset situated in India.

iv) Salary income earned in India.

v) Salary payable to Indian citizen by the Government for service outside India.

vi) A dividend paid by an Indian company outside India.

Scope of Total Income

1. The total income of any previous year of an person who is a resident in India includes all income from whatever source derived,

a) is received, or is deemed to be received in India in such year by or on behalf of such person : or

b) accrues or arises or is deemed to accrue or arise to him in India during such year; or

c) Occures or arise to him outside India during such year.

In case of a person not ordinarily resident in India, the income which accrues or arises to him outside, shall not be included unless it is derived from a business controlled or a profession set up in India.

2. The total income of any previous year of a person who is 'Non-resident' includes the following incomes from whatever source derived, which;

a) is received or deemed to be received in India in such year even if it is earned outside India; or

b) accrues or arises or is deemed to accrue or arise to him in India during such year even if it is received outside India.

1.6 Illustrations

1. Subhash, a citizen of India, left India for the first time on 1st September 2013. He comes to India on 1st Feb. 2015 and left India on 15th Feb. 2015. Find out residential status of Shri. Subhash for the A. Y. 2015-16.

Solution : During the previous year Subhash's stay in India was for 14 days only. He does not satisfy any of the conditions of Sec. 6 (i). Hence he is non-resident for the Assessment year 2015-16.

2. Pratik for the first time left for U.K. on 10th March, 2014. He returned to India on 25th Dec. 2014. Ascertain his residential status.

Solution : Pratik stayed in India for 97 days during the previous year 2014-15. Hence he was non-resident.

3. Shri. Joshi, an Indian citizen, serving in a company in New York, Comes to India every early for five months, but in the previous year 2014-15. He come to India for only fair months. State his status for previous year 2014-15.

Solution : He is non-resident as,

a) He was not in India for at least 182 days during the previous year 2014-15.

b) Though he was 365 days in India during the previous 4 years.

4. Following are the incomes of Shankarlal for the previous year.

a) Profit from hotel business in Germany Rs. 35,000.

b) Interest received from Mr. Johnson, a non-resident, on the loan provided to him for a business carried on in India Rs. 24,000.

c) Royalty received in Germany from Mr. Mahendra, a resident in India.

d) Income from business in Bangla Desh but controlled from India and remitted to India Rs. 18,000.

e) Income from sale of house situated in India Rs. 78,000.

Compute his total income for the assessment year 2015-16 if he is i) Resident, ii) Not ordinarily resident and iii) Non-resident.

Solution :

Computation of total income for A.Y. 2015-16.

Kinds of Income	Resident Rs.	Not Ordinarily Resident Rs.	Non Resident Rs.
a) Profit from Hotel business in Germany	35,000	—	—
b) Interest received from a non-resident on the loan provided to his for a business carried in India.	24,000	24,000	24,000
c) Royalty received in Germany from a resident of India for technical services provided in Germany.	76,000	—	—
d) Income from business in Bangla Desh but controlled from India and remitted to India.	18,000	18,000	—
e) Income from sale of house situated in India	78,000	78,000	78,000
Total	**2,31,000**	**1,20,000**	**1,02,000**

1.7 Self Assessment Questions

1. **Define**

i)	Assessee	ii)	Assessment year
iii)	Income	iv)	Agricultural Income
v)	Business	vi)	Previous year
vii)	Company	viii)	Person.

2. **Explain the conditions that an individual must satisfy in order to become (i) Resident (ii) Non-ordinary resident.**

3. **Explain the residential status of following assessee**

   i) Hindu Undivided Family

   ii) Partnership Firm.

   iii) Company.

4. **Write Short Notes :**

   i) Residential Status of HUF.

   ii) Assessment year & previous year.

   iii) Resident

   iv) Non-Resident

   v) Not Ordinarily resident.

5. Mr. Robert a citizen of London stayed in India for 190 days the first time during the previous year 2014-15. What would be his residential status for the previous year.

6. Mr. Narayan is a citizen of India. He has been serving in Mumbai office for the last 15 years. On 20-4-2012 he is transferred to New York office and he leaves India on the same day to take charge of that office. He is again transferred to Mumbai office and come to India on 12-9-2014.

What will be he is residential status for the previous year 2012-13, 2013-14 and 2014-15 applying the current provisions?

7. Mr. Jaswant is a citizen of India. He has been serving in Poona Office for the last 20 years. He was transferred to Tokyo Office which he is joined on 20-4-2011. He returned to India on 1-6-2012. He was sent to London office on 1-3-2014. He returned to India again on 15-3-2015.

Determine the residential status for the P. Y. 2011-12, 2012-13, 2013-14 & 2014-15.

8. Mr. Avinash furnished the following particulars of his income for the previous year ended 2014-15.

		Rs.
a)	Profit from business of Belgaum	50,000
b)	Income from house property in India	45,000
c)	Interest on Post Office Saving Bank A/c	5,000
d)	Salary received in India for service rendered in Shrilanka	40,000
e)	Money brought into India out of untaxed foreign income	25,000
f)	Income from business in Germany controlled from India and the amount was not brought to India.	35,000
g)	Profit from business in Bangla Desh the amount was received there and brought into India.	30,000

Compute the total income of Mr. Avinash for the assessment year 2015-16 if he is : i) Resident, ii) Not Ordinarily resident and iii) Non resident.

1.8 Further Readings

1. Students Guide to Income-tax : V. K. Singhania.
2. Income tax law & Practice : M. B. Kadkol.
3. Income tax – A Simple Approach : Dr. P. M. Herekar.

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Unit – 2

Exempted Incomes U/s 10 & Deductions of Chapter VI 'A' Applicable to Individual

Structure

2.0 Objectives

After going through this unit, you should be able to -

- know the meaning of exempted incomes
- understand the various types of exempted incomes U/s 10
- know the meaning of deductions
- understand the deductions of chapter VI 'A' applicable to individual

2.1 Introduction

The income Tax is a tax on the income of a person, the meaning of the term income is very important. But the income Tax Act, 1961 does not define the term income Sec. 2 & 3 of the Act, however defines the terms & expressions of the word ‘income’ these are of two types – (i) Inclusive and (ii) Exhaustive the exhaustive definition tries to explain the meaning of the term, where as the inclusive divination gives the contents included in such term.

Generally speaking, the word Income covers receipts in the shape of money or money's worth which arise with certain source. However all receipts do not from the basis of taxation under the act. For levy of Income Tax first of all the taxable income of a person should be determined as per the provisions of the Act & Rules. The Taxable income should be computed under the five heads. The total of such net amount is called Gross total Income. There are other permissible deductions under the act which are to be deducted from Gross Total Income. But there are some Incomes are not included in the above income.

Exemptions available U/s 10, 10A, 10 B, 13 A & deductions under 80C to 80U are of special nature of are allowed to certain limits.

These exemptions and deductions available under the act may be broadly be grouped as " –

(a) tax free Income (sec. 10,10 A,10 B &13 A)

(b) Deductions from Gross Total Incomes (Sec. 80C to 80U)

In this chapter, we are going to study exempted Incomes & deductions of chapter VI 'A' applicable to Individual.

2.2 Incomes Exempted from tax U/s 10

In the following cases, income is exempt from tax.

1. Agricultural Income [sec.10(1)]

Agricultural Income is fully exempted. However, the net agriculture income is taken into account in income liable to tax. (for details refer pervious chapter).

2. Any sum/receipts received from Hindu Undivided family (HUF) [sec10 (2)]

Any sum/receipts received by an Individual as a member of Hindu undivided family or out of income of estate belonging to the family is exempt from tax. Such receipts are not chargeable to tax in the hands of an Individual member ever if tax is not paid or payable by the receipts from a HUF are, however taxable vide sec. 64 (2).

3. Share of profit from a partnership firm [sec.10(2A)] –

Share of profit received by partners from a firm (which is assessed as firm) is not taxable in the hands of partners. However, such share of a partner should be computed by dividing the taxable profit of the firm in the same proportions as per the profit sharing ratio mentioned in the partnership deed.

4. Interest received by a Non Resident – [sec. 10 (4) (4B)]

The following interest income are exempt from tax -

(a) any income of a non resident by way of interest on notified Government Securities (including premium on redemption of such bonds) – sec. 10 (4) (i)

(b) Income from interest standing to credit in a Non Resident (external) Account in India, in accordance with the FERA1973 or a person who has been Permitted by the RBI to maintain the a foreside account – sec. 10 4 (ii) and

(c) In the case of an, Indian citizen or a person of Indian origin who is a non resident, National saving certificates VI & VII Issues if such certificates are subscribed from outside thorough official channels – sec 10 4 (B)

5. Leave Travel concession to an Indian citizen – [sec10(5)]

The exemption in respect of value of leave travel concession is available to an Indian citizen. The value of any travel concession received by or due to an individual from his employer for himself and his family while proceeding on leave to any place in India is exempt. Such concession received from his present or former employer after retirement or after termination of his service is also exempt.

The amount to be exempted should not exceed the amount of expenses actually incurred for the purpose of such travel.

The cremation is available to an employee in respect of two journeys performed in a black of 4 calendar years commencing from 1986. if such concession is not availed of by him during a black of 4 calendar years, the amount received by him in the first calendar year in the previous block of 4 years is eligible for exemption. Here. "family" means the spouse, children, parents, brothers and sisters mainly dependent on the Individual.

6. Death – cum retirement gratuity [sec. 10 (10)]

(a) Any gratuity received by the employees of Government or semi Government department including the employees of a local authority, is FULLY EXEMPT.

(b) Any gratuity received by employees Covered by the payment of Gratuity Act 1972, is exempt to the extent that it is payable as per the provisions of that Act being the least of the following (i) Actual Gratuity received (ii) Rs. 7,00,000 (iii) 15 days salary (7 days in the case of employees of seasonal establishment) based on salary last drawn for each completed year of service or part there of exceeding 6 months

(c) Any other gravity received by on employee from the employer of private sector /corporations on his retirement or becoming in capacitated, or on termination is exempt being the least of the following : -

(i) half month's average salary for each year of Completed Service.

(ii) maximum limit Rs. 7,00,000.

(iii) Actual gratuity received.

The average salary is calculated on the basis of 10 months preceding the month in which the gravity is paid. For this purpose salary means "Basic pay +Dearness allowance (if the terms of employment provides) +Commission (if it is based on percentage of turnover)

7. Retrenchment Compensation [sec.10(10B)]

Any compensation on received by a workman under the Industrial Despots Act 1947 or other Act Rules or orders or Awards at the time of his retrenchment, is exempt to the extent of the amount calculated as per the provisions of the Industrial Disputes act 1947 or an amount not being less than Rs. 5,00,000 as notified by the Government whichever is less.

8. Compensation Under Bhopal Gas Leak Disaster Act [sec.10 (10BB)]

Compensation received by an assessee under the provisions of Bhopal Gas Leak Disaster (processions of claims) Act 1985 and any scheme framed there under, is exempt from tax. However, any payment or Compensation received by an assessee in connection with Bhopal Gas Leaks Disaster, to the extent he has been allowed as deduction from his taxable income on account of any loss or damage caused to him, will not be exempt from tax.

9. Compensation on Voluntary Retirement [sec.10 (10C)]

Any compensation received by an employees of a public sector company or of any other company or local authority or an authority set up under government Act or co-operative society or university or India institute of technology or specified institute of management on his retirement, is exempt subject to a maximum limit of Rs. 5,00,000 in accordance with the scheme formed there under [Rule 2 BA]. In the case of Companies the scheme should be approved by the chief Commissioner or Director General as the case may be. Further if such exemption has been allowed for any employee for any assessment year, no exemption will be allowed again for any other assessment year.

10. Payment from Provident Fund [sec. 10 (11)]

Provident fund scheme is a retirement benefit scheme. Any payment from a provident fund to which provident fund Act 1925 (statutory provident fund) or any other provident fund set up by central government and notified in the official gazette is totally exempt from tax.

11. Sum received from life Insurance Policy [sec. 10 (12)]

Any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy, shall not be included in the total income of a persons. The exemption is however not available in respect of such polices which is in sec. 8- DDA (3) or under key man insurance policy.

12. Payment from an approved super annuation fund [sec. 10(13)]

The payment form this fund is exempt it is paid :-

(i) on the death of a beneficiary or

(ii) to an employee in lieu of or in Commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated before such retirement or

(iii) by way of refund of Contributions on the death of beneficiary or

(iv) by way of refund of contributions to an employee on his leaving the service with which the fund is established and where the retirement and other conditions are not applications and the interest there on.

13. House Rent Allowance : [sec.10 (13A)] –

The house rent allowance actually received by an employee specially granted to him by his employer to meet the expenditure incurred on rent, is exempt to the extent of the least of the following –

(i) HRA actually received

(ii) The excess of rent paid over 10%of salary

(iii) (a) 50% of salary if the house is situated in Mumbai, Kolkata, Chennai & Delhi (b) 40% of salary if the house is situated at any other place. “salary for this propose” is equal to Basic salary +D.A. (if terms of employment provides) + Commission (if based on Fixed percentage).

The period of occupation of the house by the assesses during the previous year is to be taken into account for the above calculation.

14. Interest on Certain Government Securities: [sec. 10 (15)] –

The interest received from any of following securities is exempt :

(1) interest on notified Securities, bonds or certificates (2) Interest on 10%Relief Bonds (for Individual / HUF only) (3) Interest on notified bonds / debentures of a public sector Company (4) 12 years National saving annuity Certificates (5) National defence Gold Bonds (6) Post office cash certificates (5 years) (7) Post office National Saving certificates (12 years / 7 years) (8) Post office Saving Bank Account (9) Post office Cumulative Time Deposit Rules 1981 (10) Scheme of fixed deposits governed by Government Saving Certificates Rules (11) National defence Gold Bonds (12) special Bearer Bonds 1991 (13) Treasury Saving Deposit Certificates (10 years) (14) Special deposit Scheme 1987 (15) Resurgent India Bonds (16) 7% Saving Bonds 2002.

15. Educational Scholarships: [sec. 10 (16)]

Scholarship granted to meet the cost of education is exempt from tax. In order to avail the exemption it is not necessary that the government should finance scholarship.

16. Daily allowance of Members of Parliament

Sec. 10 (17) Clause (17) of section 10 provides exemption to Members of parliament of state Legislature in respect of the following allowances :

(a) Daily allowance Entire amount is exempt. (b) any other allowance received by a Member of parliament under the Members of Parliament (Constituency allowance)Rules 1986 and (c) all other allowances (not exceeding Rs.2000 P.M.) received by any person by reason of his Membership of any state legislature or any Committee there of, which the Central Government may notify.

17. Awards &Rewards : [sec. 10 (17A)]

The following payment received either in cash or in kind are exempt – (a) Any award Instituted in the public interest by the government or any other approved public body (b) any reward received from the government for such purpose that are approved in the public interest.

18. Annual Value of palace of a Ruler [sec.10(19A)]

The annual value of any one palace in the occupation of a Ruler during the pervious year, is exempt provided such exemption was given be before the commencement of the Constitution Act 1971.

19. Dividends of Domestic Companies [sec. (34)]

Any income by way of dividends of Indian Companies referred to in sec.115 is exempt from tax, in the hands of recipient.

20. Income from units of Mutual Fund [sec. 10 (35)]

Any income received in respect of the units of Mutual fund specified under clause 10 (23D) & units of UTI or specified Company are exempt from tax, in the hands of recipients.

Other important exemptions are as under –

(i) Income of employees stats Insurance Fund [sec.10(25A)]

(ii) Income of National Minorities Development and finance corporation [sec10(26B B)]

(iii) Subsidy form Tea Board [sec.(10 (30)]

(iv) Subsidy received by planters [sec10(31)]

(v) Capital Gains on transfer of U/s 64 [sec.10 (33)]

(vi) Capital Gains on transfer of listed equity shares [sec.10 (36)]

(vii) Income of an International sporting event [sec.10 (39)]

(viii) Grant received by subsidiary Company from holding Company sec.10 (40)

(ix) Income of Insurance Regulatory Authority [sec. 10 (23BBC)

(x) Pension or family pension of gallantry award winners sec. 10 (18).

2.3 Deductions under Chapter VI 'A' applicable to Individual

The Chapter VI 'A' of the Income tax act provides for the deductions an assessee can claim in Computing the total Income. It includes sec. 80C to 80U these are explained as :-

1. Deductions U/s 80 C –

The following are the main provisions of sec. 80C.

(i) It is available from Gross total Income.

(ii) It is available to Individual or HUF.

(iii) It is available on the basis of specified qualifying investments/contributions etc. can be made out of taxable income

(iv) Maximum amt. of deduction is Rs.1.5 Lakhs.

- Computation of deductions u/s 80c –

Following are the 2 steps,

Step I – Gross Qualifying amt.

Step II – Amt. of deduction.

Step I – Gross qualifying amt. It is the aggregate of the following –

(1) Life Insurance premium.

(2) Contribution towards statutory PF and Recognized PF.

(3) Contribution towards PPF.

(4) Contribution towards approved super annuation fund.

5) Subscription to NSS VIII issue.

6) Contribution to ULIP scheme by UIT, LIC mutual fund.

7) Payment for notified annuity plan of LIC. (e.g. New Jeevan Dhara, New Jeevan akshay.)

8) Payment in respect of non-commutable deferred annuity.

9) Subscription towards notified units of mutual Fund.

10) Contribution to notified pension fund. (set up by mutual fund or UIT)

11) Any sum deducted from salary payable to Govt. Employee for the purpose of serving him a deferred annuity (subject to a maximum of 20%of salary)

12) Any sum paid (including accrued interest) as subscription to home loan account scheme of National housing bank.

13) Any sum paid as tuition fees to any university/college /educational institution.

14) Any payment towards the cost of purchase or construction of residential property (including repayment of loan taken from Govt. bank LIC,NHB etc.)

15) Amount invested in approved debenture /equity shares (in a public co. engaged in infrastructure, power sector, etc.)

16) Amount deposited as a term deposit for a period of 5 years or more.

17) Subscription to any notified bonds of NABARD.

Step II : Amount of deduction

- The amount of deduction is calculated as,

  (a) Gross qualifying amount. (step I amount.)

  (b) Rs. 1,50,000 whichever is lower.

2. Deduction under Sec. 80 D - Medical Insurance Premia

   (i) Taxpayer is an individual

   (ii) Insurance scheme is framed by central insurance company & approved by central government

   (iii) It is essential to issue cheque of insurance premium by an assessee

   (iv) Premium is paid out of income chargeable to tax.

   (v) Mediclaim policy is taken on the health of Individual, this spouse, dependent parents, dependent children.

   (vi) Mediclaim policy is taken on the health of any member of the family, in case of HUF.

Amount of deduction –

It above conditions are satisfied then the insurance premium paid or 15000 whichever is lower, is deductible (maximum amt. of Rs. 15000 increased to Rs. 20000 if the family Member consist a senior citizen).

3. Sec. 80 DD- Deduction in respect of maintenance including medical treatment of handicapped dependent –

The assesses should be either an individual or a HUF. He may have incurred some amount for medical treatment or training or rehabilitation of handicapped dependent or may have deposited some amount in an approved scheme by LIC or UIT for such handicapped dependent.

The subscriber should have made nomination of either handicapped dependent or any other person, trust to receive the payment and use it for the benefit of handicapped dependent. The assesses can claim deduction under this section of Rs50000 (A higher deduction of Rs 1,00,000 shall be allowed it dependent is a person having disability ever 80%)

4. Sec. 80 DDB – Deduction in respect of medical Treatment –

The deduction is available to individual and a HUF. The assessee should have actually incurred some expenditure on medical treatment for specified ailments. In case of an individual the expenditure might be for himself or any dependent relative. for HUF it can be for any Member of is Rs. 40,000 and if the patient is a senior citizen the amount of deduction shall be Rs. 60,000 or the expenditure actually incurred whichever is lower.

5. Sec. 80 E – Deduction in respect of Interest of loan taken for higher educations.

The assessee should be an individual. It is available to student & not to parent. Loan is taken from any financial institution or banking company. The deduction is available for maximum 7 years & it is available only for amount paid by way of interest & not for repayment of principal Loan amount.

6. Sec. 80G – Deductions in respect of Donations –

Only donations in cash qualify for the deduction. Generally the Qualifying Amount of donations should not exceed 10% of Gross total Income after deductions allowed under chapter VI 'A'.

Dontations to following funds / Institutions are100% deductible.

(i) National Defence fund by Central Govt.

(ii) Prime Minister National Relief fund

(iii) National foundation for communal harmony.

(iv) Any State Government Fund for providing medical relief to tried poor.

(v) Chief Minister's Earthquake Fund, Maharashtra.

(vi) Zilla Saksharta Samiti.

(vii) Central welfare fund of army &air force.

(viii) Andra Pradesh chief minister cyclone relief fund.

(ix) National Illness Assistant fund.

(x) National sports fund or National cultural fund.

Donations to following are 50% deductible-

(1) Any notified temple, mosque, gurudwar church or other place of workshop.

(2) Any corporation specified in sec. 10 (26BB) for promoting interest of minority community.

(3) Any other fund or institution which satisfies conditions in 80F(5)

(4) Jawaharlal National Memorial fund

(5) Prime Minister's Drought Relief fund.

(6) Indira Gandhi Memorial Trust.

(7) Rajiv Gandhi foundation

The above deductions are available only to Individual.

2.4 Summary

Sec. 10 of Income Tax Act. 1961 enumerates income which are tax free. They are called exempted incomes. These incomes are not included in computing the total income of on assessee. Any income falling within only of the clauses in sec. 10 shall be exempted. The burden of proving that of particulars item of income falls within this section is on the assessee. Some of the important exempted are agriculture income, receipts from HUF, share of income/ profits from firm, Gratuity etc.

In computing the total income of an assessee, certain deductions, are available from gross total Income. Such deductions are contained in chapter VI 'A' of the Act. And they have been specified in sec. 80C to 80U. The aggregate amount of deductions u/s 80C to 80U cannot exceed Gross Total Income. The main purpose of these deductions is to encourage saving of the people. Every sections in this chapter VI A explains basis of calculations of these deductions.

2.5 Key terms

1. Exempted Incomes : Sec. 10 of Income tax Act 1961 contains Incomes which are tax free. These incomes are called exempted Incomes. These incomes are not to be included in computing the total income of an assessee.

2. Deductions of Chapter VI 'A' : Chapter VI 'A' of Income Tax Act. 1961 contains certain deductions which are available to assessees. These deductions can be claim by assesses while Computing his total Income. Chapter VI 'A' covers sec. 80C to 80U.

3. Exemption and Deductions : Exemption covers Incomes which are not taxable where as deductions covers incomes which are allowed to be deducted from Gross total Income.

2.6 Self-Assessment Questions

(A) Objective Type Questions

I. Choose the correct alternative :

1. Maximum limit of exemption u/s 10(10)in respect of gratuity is …………..

   (a) Rs. 2,50,000 (b) Rs. 3,50,000 (c) Rs. 5,00,000 (d) Rs. 7,00,000

2. Agriculture income is ………..

   (a) fully exempted (b) fully taxable

   (c) Partially taxable (d) None of the above

3. Sec. 80 DD in respect of maintenance of handicapped dependent available to …………

   (a) Individual (b) Individual & HUF only

   (c) HUF (d) HUF, firm & company.

4. Medical Insurance Premium u/s 80 D available only when it is paid by –
   (a) cash (b) cheques (c) DD (d) all of the above.
5. Donation to National Defence fund is .... % deductible.
   (a) 50% (b) 60 (c) 70 (d) 100

Ans. : [1. d 2. a 3. b 4. b 5. d]

II State True or False.

1. Section 10 of income tax Act Contains all exemption income
2. Deduction U/s 80E is in relation to donations.
3. Any Grauity received by Govt., semi Govt. employee is taxable.
4. Donations given to Prime Minister's Draught relief fund is deductible at 100% from total Income.
5. Maximum limit of deduction U/s 80C is Rs. 1,50,000.

Ans. : [1. T 2. F 3. F 4. F 5. T]

(B) Short answer questions –

1. Explain House Rent Allowance u/s 10 (13A).
2. Explain Interest on Certain Govt. Securities [sec 10 (15)]
3. Explain Medical Insurance Premium u/s 80 D.
4. Explain Deduction in respect of donations u/s 80 G.
5. Explain any 8 incomes exempted from income tax.

(c) Essay Type Questions –

1. Enumerate incomes which are totally exempt.
2. Explain briefly the provisions of the Income tax Act 1961, regarding deductions allowable in computing the total income of the Individual.
3. Explain briefly the provisions of sec. 80C and 80 D.

2.7 Further Readings

1.	**Students Guide to Income Tax**	: **Dr. Vinod singhania** **Dr. Monica Singhania.**
2.	**Income Tax Rules 1961**	: Taxman publication
3.	Direct Tax Laws	: Dinkar Pagare Sultanchand & sons publication
4.	Income Tax Laws & Practice	: Dr. Mehotra H.C.

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Unit - 3

Heads of Income

(Computation of Total Income)

Structure

3.0 Objectives

After going through this unit, you should be able to

- Know the heads of income.
- Understand steps involved in computation of total income.
- Compute total income of an individuals.

3.1 Introduction

An individual means a human being including male, female, minor, major or a person of unsound mind. The assessment of individual refers to the computation of the total income of an individual for income-tax purpose.

3.2 Steps Involved in Computation Total Income

The procedure of such computation includes following steps :

1. Ascertain the income of an individual as per the provisions in the Act, under the various heads such as salaries, income from house property, profits and gains of business or profession, capital gains and income from other

sources. The residential status of an individual should be taken into consideration while computing such income under various heads.

2. The proper effect should be given to the unabsorbed losses and allowances brought forward from the earlier years.

3. The gross total income should be calculated by additing the incomes of an individual from all the heads.

4. The deductions under section 80C to 80U, if any, should be claimed from the gross total income. The balance represents to total taxable income of an individual.

5. Finally, tax liability on total taxable income should be computed by taking into consideration advance tax, if any, paid by him.

3.3 Important points to be Remembered

While computing the total income of an individual assessee, the following points also should be remembered :

1. Income as a member of Hindu Undivided Family : A share received by an individual as a member of H.U.F. is exempt form tax u/s 10 (2), even though H.U.F. has not paid any tax on its income.

2. Income received as a partner of a firm : The share in the profits of a firm (which is assessed as a firm) received by an individual as a partner is exempt from tax u/s 10 (2A). But the remuneration in the form of a salary, bonus, commission or any interest received by him from the firm in the capacity of working partner is taxable as income from business.

3. Income received as a member of AOP or BOI : A share received by an individual as a member of 'Association of Persons' or 'Body of Individuals' is dealt with as under u/s 67 (a).

(a) In case the total income of the association or body is taxable at maximum marginal rates or at any higher rate the share received by member from its income will not be included.

(b) In case the total income of association or body is taxable at the usual rates, the share of member is included in his total income. However, he is entitled for a rebate of tax at an average rate on such income.

(c) In case the total income of association or body is not liable for tax, the share of member in such income is included in his total income. But he is not entitled for a rebate of tax.

4. Devidend received as a member of domestic company : It is exempt from tax u/s 10 (34), hence not included in his individual income.

5. Dividend received as a member of co-operative institution : It is included in the individual income of a member.

Proforma Showing Computation of Total Income of

Legal Status : **Previous Year :**

Residential Status : **Assessment Year :**

Particulars	Rs.	Rs.
(I) Income from salary		x x
(II) Income from house property :		
(a) Self Occupied	x x	
(b) Let out	x x	x x
(III) Income from business or Profession		x x
(IV) Capital Gains		x x
(V) Income from other sources		x x
Gross Total Income (Total I to V)		**x x**
Less : Deductions under chapter VIA u/s 80 C to 80 U		x x
Total Taxable Income		**x x**
(A) Tax payable		x x
Add : Education cess 3% on IT + SC		x x
Total tax Payable		**x x**

3.4 Illustrations

Illustration 1 : Mr. Shamprasad, who is an employee of a company at Ahemadabad, (population exceeds 30 lakhs) furnishes the following particulars of his income.

1. Basic salary Rs. 3,000 per month.
2. Dearness Allowance Rs. 500 per month (not eligible for retirement benefits).
3. Bonus Rs. 10,000 p.a.
4. Commission fixed Rs. 25,000.
5. Employee's contribution to Recognised Provident Fund Rs. 5,000 to which employer contributes a matching sum.
6. Interest credited to Provident fund at 10% p.a. Rs. 6,000.
7. Entertainment Allowance Rs. 600 per month (He was receiving from the company Rs. 300 per month prior to 1-4-2000).
8. He was provided with a rent free accommodation of fair rent of Rs. 20,000 per year. The cost of furniture are provided amounted to Rs. 10,000.

Mr. Shamprasad is the owner of a house property of the municipal value of Rs. 18,000. It has been let out at Rs. 2,000 per month. Municipal taxes amount to 10% of the municipal value and 30% of the municipal taxes are borne by the tenant. The house remained vacant for two months during the year.

Besides he has received Rs. 70,000 as interest on bank deposits. His investments & expenditure during the year were :

Payment of LIC premium on own life Rs. 3,000, Donation to Prime Minister's National Relief Fund Rs. 5,000. Professional Tax Rs. 200 p.m.

Mediclaim insurance premium for family Rs. 1,200.

Compute his total income for the A. Y. 2015-16.

Solution

Computation of the Total Income of Mr. Shamprasad
for A. Y. 2015-16

Particulars	Rs.	Rs.	Rs.
(I) Income from Salary :			
Basic Salary 3,000 x 12		36,000	
Dearness Allowance 500 x 12		6,000	
Bonus		10,000	
Commission		25,000	
Annual accretion to R.P.F.			
Employers contribution	5,000		
Less : 12% of salary (Rs. 36,000)	4,320	680	
Interest exceeding 9.5% (6000x0.5/10)		3,00	
Entertainment Allowance @ Rs.600 p.m.		7,200	
Rent free furnished accommodation		12,730	
Gross Salary		97,910	
Less : 1. Prof. Tax u/s 16 (iii)		2,400	95,510
(II) Income from house property (let out) :			
Gross Annual Value :			
(a) Municipal Value	18,000		
(b) Fair Rent	---		
(c) Rental Value	24,000		
(d) Annual Lettable Value (Higher of (a) and (b) above)	18,000		
(e) Gross Annual Value (Higher of (c) and (d) above)	24,000		
Less : Vacancy period Rent	4,000	20,000	
Less : Municipal Taxes paid, by owner			

(conted. on next page)

(70% of Rs. 1,800)		1,260	
Annual Value		18,740	
Less : Deductions u/s 24			
(i) Standard deduction			
(30% of Annual Value)	5,622	5,622	13,118
(III) Income from other Sources :			
Interest on bank deposits			70,000
Gross Total Income			1,78,628
Less : Deductions u/s 80			
1. LIC Premium, RPF etc u/s 80 C		8,000	
2. Donations u/s 80 G		5,000	
3. Mediclaim u/s 80 D		1,200	14,200
Total Taxable Income			**1,64,428**

[Working Notes :

1. *Valuation of rent free furnished accommodation owned by employer at Ahemadabad*

Salary :		*15% of salary of Rs. 78,200 i.e. ....*	*11,730*
Basic	*36,000*	*Add : 10% of cost of furniture*	*1,000*
DA (if enters)	*NIL*	*I Value of furnished house*	*12,730*
Bonus	*10,000*	*(FRV not to be considered for valuation of accommodation)*	
Commission	*25,000*		
Taxable Ent. Allow	*7,200*	***Note :*** *as Fair rent of house is given instead of rent paid by the employer for the accommodation, it is assumed that the accommodation is owned by employer.*	
	78,200		

Population of Ahemadabad exceeds 25 lakh and as fair rent is given accommodation is owned by the emploer hence valuation of accomodation is done at 15%.

2. *Deduction for entertainment allowance u/s 16 (ii) cannot be claimed as the assesee is non government employee. Untill the P. Y. 2000-01 they were eligible for this deduction. While computing this deduction the entertainment allowance received prior to 1-4-1955 was one of the the limits.*

3. *Assessee can claim deduction u/s 80 C in respect of his contribution ro RPF and payment of LIC premium.*

4. *D. A. does not enter retirement benefit and commission of fixed (i.e. not based on turnover) hence not included in salary for the purpose of calculation accretion of RPF.* ***]***

Illustration 2 : Mr. Rajmani is employed with M/s. EXPRESSIONS PVT. LTD., Mapusa. From the following information pertaining to the year ending 31st March, 2015. Compute his total Income :-

	Rs.
Basic salary (after deducting TDS and own contribution to Recognised P.F.)	60,000
Tax Deducted at source	8,000
Bonus	10,000
Employer's contribution ro recognised P.F.	9,000
(Employee also contributes an equal amount)	
Entertainment Allowance	9,500
House Rent Allowance	6,000

He is also the owner of a residential house property which he has let out to his friend Murlidhar for annual rent of Rs. 48,000. The fair rent is Rs. 50,000 and Municipal Valuation Rs. 45,000. He incurred the following expenses in connection with the said property during the previous year 2008-09.

(i) Municipal Taxes @ 10%.

(ii) Repairs and white wash due but not paid Rs. 5,000.

(iii) Insurance Premium paid Rs. 4,000.

(iv) Ground Rent due but not paid Rs. 1,000.

(v) Interest paid on capital borrowed by his late father for constructing this property Rs. 10,500.

(vi) Salary to rent collector Rs. 3,000.

Mr. Rajmani donated Rs. 8,000 to Goa University and spent Rs. 5,500 per month on medical treatement of his dependents on who is permanently physically handicapped.

He paid a rent of Rs. 1,000 per month for a house where he stays and a professional tax @ Rs. 250 p.m.

Computation of the Total Income of Mr. Rajmani
for A. Y. 2015-16

Particulars		Rs.	Rs.	Rs.
(I)	**Income from Salary :**			
	Basic Pay (Net)	60,000		
	Add : 1. Tax Deducted at source	8,000		
2.	Contribution to R.P.F.	9,000	77,000	
	Bonus		10,000	
	Employer's contribution to RPF exceeding 12% of salary Rs. 77,000		NIL	
	Entertainment Allowance		9,500	
	House Rent Allowance	6,000		
	Less : Exempt u/s 10 (13A) W.N.1	4,300	1,700	
	Gross Salary		98,200	
	Less : 1. Profession Tax u/s 16 (iii)	3,000		
	2. Entertainment Allowance	NIL	3,000	95,200
(II)	**Income from house property (let out) :**			
	Gross Annual Value :			
	(a) Municipal Value	45,000		
	(b) Fair Rent Value	50,000		
	(c) Annual Rent Value	48,000		
	(d) Annual Lettable Value (Higher of (a) and (b) above)	50,000		
	(e) Gross Annual Value (Higher of (c) and (d) above)		50,000	
	Less : Municipal Taxes paid 10% of M.V.		4,500	
	Annual Value		45,500	
	Less : Deduction u/s 24 (1)			
	Standard deduction (30% A.V.)	13,650		
	Insurance premium paid	NIL		
	Ground Rent due	NIL		
	Interest on housing loan	10,500	24,150	21,350

(conted. on next page)

Gross Total Income			1,16,550
Less : 1. Deductions for RPF Contribution u/s 80 C		9,000	
2. Deduction for handicapped dependent u/s 80 DD		50,000	
3. Deduction for donation u/s 80 G		8,000	67,000
Total Taxable Income			**49,550**

[Working Notes :

1. *Exemption for House Rent Allowance u/s 10 (13A).*

				Rs.	***Rs.***
Salary :		*(a)*	*Actual H.R.A. received*		*6,000*
Basic	*77,000*	*(b)*	*Rent Paid*	*12,000*	
DA (if enters)	*NIL*		*Less : 10% of salary*	*7,700*	*4,300*
	77,000	*(c)*	*40% of salary*		*38,800*
Rent paid	*12,000*		*whichever is less is exempt i.e.*		*4,300*

2. *If the handicapped dependent is severely handicapped (i.e. 80% or more) the deduction u/s 80 DD is increased to Rs. 1,00,000 instead of Rs. 50,000.*

3. *Interest on capital borrowed for construction by father is deductible u/s 24. But other expenses such as while wash expenses, repairs, rent collection charges, insurance etc. are not deductible.]*

Illustration 3 : Mr. Babu of Bangalore submits the following trading and Profit and Loss Account for the year ending 31-3-2015.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	60,000	By Sales	4,20,000
To Purchases	3,80,000	By Closing Stock	80,000
To Freight	15,000		
To Gross Profit c/d	45,000		
	5,00,000		5,00,000

(conted. on next page)

Particulars	Rs.	Particulars	Rs.
To Salaries and Wages	14,800	By Gross Profit b/d	45,000
To Rent and Taxes	3,800	By Dividend from	
To Income-Tax	600	co-operative society	2,000
To Household Expenses	4,200	By Rent from buildings	
To Postage and Telegram	400	let out	4,800
To Donation	500		
To Audit fees	200		
To Provision for bad debt	680		
To Bad debts	420		
To Miscellaneous Expenses	600		
To Depreciation	500		
To Net Profit	25,100		
	51,800		51,800

The following information is available :

1. He is also an employee in a cinema company and receives salary of Rs. 60,000 during the year & paid professional tax @ Rs. 100 p.m.
2. Purchases include Rs. 5,000 being advance to suppliers in March, 2014 against goods to be delivered in April, 2014.
3. Rent and taxes include Rs. 2,300 being municipal taxes paid for the building let out.
4. Donation is paid to the Indian Naval Benevolent fund.
5. Miscellaneous expenses include Rs. 400 being puchase of books for the employment.
6. Depreciation allowable as per rules is Rs. 400.

Compute his total income for the A. Y. 2015-16.

Solution

Computation of the Total Income of Mr. Babu for A. Y. 2015-16

Particulars	Rs.	Rs.	Rs.
(I) Income from Salary :			
Gross Salary		60,000	
Less : Professional Tax u/s 16 (iii)		1,200	58,800
(II) Income from house property			
Gross Annual Value - Rent		4,800	
Less : Municipal Taxes paid		2,300	
Annual Value		2,500	
Less : Sandard Deduction (30% annual value)		750	1,750
(III) Income from business :			
Net Profit		25,100	
Add : Inadmissible Expenses :			
Advances included in purchase	5,000		
Income Tax	600		
Household expenses	4,200		
Donation	500		
Provision for bad debts	680		
Books for employment	400		
Depreciation	500		
Municipal Taxes	2,300	14,180	
		39,280	
Less : Inadmissible incomes :			
Dividend from co-operative society	2,000		
Rent from buildings (let out)	4,800	6,800	
		32,480	
Less : Depreciation as per rules		400	32,080
(IV) Income from other Sources :			
Dividend from co-operative society			2,000
Gross Total Income			94,630
Less : Deductions for donations u/s 80 G			500
Total Taxable Income			**94,130**

Note : *Advance for purchases is inadmissible because it is not actual purchase.*

Illustration 4 : The following is the summary of cash transactions of Dr. V. Kumar for the previous year ending 31-3-2015.

Particulars	Rs.	Particulars	Rs.
Opening Stock	24,800	Rent of Hospital	26,000
Consulation Fees	1,50,000	Staff Salary	28,000
Rent from house property	24,000	Cost of Medicines	25,000
Visiting Fees	48,000	Surgical Equipments	30,000
Sale of Medicines	78,000	Income-tax	6,000
Gifts	30,000	Medical Books	8,000
Pathological test fees	40,000	Magazines	4,000
Interest on Government		General Expenses	8,000
Securities	4,000	Household Expenses	1,42,000
Interest on Post Office		Municipal Taxes	2,000
S.B. Account	3,000	Repairs	4,000
Dividend from Indian		Fire Insurance	600
Company	8,000	Wealth Tax	14,000
Lottery Income (Net)	34,550	Deposits in post office	30,000
		Car Expenses	4,000
		Donations	18,000
		Charity	1,000
		Laboratory Expenses	6,000
		Collection Charges	500
		Closing Balance	87,250
	4,44,350		4,44,350

Other Information

(a) Municipal taxes, fire insurance and repairs are in connection with house property let out.

(b) On 31-3-2015 there was a stock of medicines of Rs. 5,000.

(c) Gifts include Rs. 8,000 from father-in-law and the balance from patients.

(d) Depreciation as per rules Rs. 10,000 on all blocks of assets including on books and the portion applicable on car.

(e) Magazines of Rs. 2,000 only were related to profession.

(f) Household expenses included Rs. 2000 payment made by cheque on 'mediclaim' scheme and Rs. 10,000 paid as premium on own life policy to LIC.

(g) One-fourth of car expenses were related to personal use.

(h) Collection charges Rs. 100 for dividend and Rs. 400 for house property.

(i) Donations were given to National Blood Transfusion Council.

Compute his total income for the assessment year 2015-16.

Solution

Computation of the Total Income of Dr. V. Kumar for A. Y. 2015-16

Particulars	Rs.	Rs.	Rs.
(I) Income from Profession :			
Taxable profession incomes :			
Consultation fees	1,50,000		
Visiting fees	48,000		
Sale of medicines	78,000		
Gifts from patients (30,000 - 8,000)	22,000		
Pathological test fees	40,000	3,38,000	
Less : Allowable deductions :			
Rent of Hospital	26,000		
Staff Salary	28,000		
Cost of Medicines (25,000 - 5,000)	20,000		
Magazines of profession	2,000		
General expenses	8,000		
Laboratory expenses	6,000		
Depreciation	10,000		
Car expenses (4,000 x 3/4 office)	3,000	1,03,000	2,35,000

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(II) Income from house property (let out)			
Gross Annual Value - Rent		24,000	
Less : Municipal Taxes paid		2,000	
Annual Value		22,000	
Less : Standard deduction (30% A.V.)	6,600		
Fire Insurance	NIL	6,600	15,400
(III) Income from other Sources			
Interest on Government Securities		4,000	
Interest on Post Office S. B. A/c	3,000		
Less : Exempt u/s 10 (15)	3,000	NIL	
Dividend from Indian Company	8,000		
Less : Exempt u/s 10 (34)	8,000	NIL	
Lottery Income		50,000	
(34,550 x 100/69.1)			54,000
Gross Total Income			3,04,400
Less : 1. Deduction for Life Insurance Premium (own) u/s 80 C		10,000	
2. Deduction in respect of mediclaim u/s 80 D		2,000	
3. Deduction in respect of Donation u/s 80 G		18,000	30,000
Total Taxable Income			**2,74,400**

Illustration 5 : Mr. Shivaji is a practicing lawyer at Nashik. He keeps his books on cash basis. From the following particulars furnished by him for the previous year ended 31-3-2015, compute his total income :

Receipts during the year :	**Rs.**
Opening balance (1-4-2014)	2,05,000
Legal fees	2,70,000
Special commission fess	500

Salary for part time lectures in a college	48,000
Examinership fees from university	2,600
Interest on bank depostis	2,000
Dividend from co-operative society	1,000
Directors sitting fees	10,000

Payments during the year :

Subscription to law journal	3,400
Law books purchased (Non annuals) (before 30-09-2014)	24,000
Rent of premises	21,500
Electrical charges	4,000
Car expenses	22,000
Office expenses	5,000
Gift to daughter	11,000
Income tax	22,000
Household expenses	95,000
Cost of typewriter (purchaed on 2-4-2014)	7,800
Donation to approved institution	1,000
Purchase of car on 1-11-2014	2,20,000
Life Insurance premium on self	6,000
Closing balance (31-3-2015)	1,15,500

Additional Information :

(a) Half of the premises is used for office and the other half for his residence. Rent & electrical charges are charged accordingly.

(b) Half of the car expenses pertain to private use.

(c) Depreciation allowance is 15% on car, 15% on typewriter and 100% on books.

(d) He paid professional tax @ Rs. 50 p.m.

Solution

Computation of the Total Income of Mr. Shivaji for A. Y. 2015-16

Particulars	Rs.	Rs.	Rs.
(I) Income from Profession :			
Allowable Profession incomes :			
Leagal fees	2,70,000		
Special commission fees	500	2,70,500	
Less : Allowable expenses :			
Subsciption to law journals	3,400		
Rent of premises (half)	10,750		
Electricity charges (half)	2,000		
Car expenses (half)	11,000		
Office expenses	5,000		
Depreciation on :			
Car @ 15% on Rs. 2,20,000			
(33,000 x 1/2 x 1/2)	8,250		
Typewriter 15% on Rs. 7,800	1,170		
Books at 100%	2,400	43,970	2,26,530
(II) Income from Salary			
Salary		48,000	
Less : Professional Tax u/s 16 (iii)		600	47,400
(III) Income from other Sources :			
Examinership fees from university		2,600	
Interest on bank deposits		2,000	
Dividend from co-operative society		1,000	
Director's sitting fees		10,000	15,600
Gross Total Income			2,89,530
Less : Deduction for donation u/s 80 G			
(50 % of Rs. 1,000)		5,00	
Deduction u/s 80 C for LIC		6,000	6,500
Total Taxable Income			**2,83,030**

*[**Notes :** 1. Half of rent, electricity and car expenses are for private use hence disallowed.*

2. Car is used for less than 180 days hence half of depreciation is allowable - out of which again half is used for office work hence allowable.]

Illustration 6 : Following is the Income and Expenditure Account of a medical practitioner for the previous year ending 31-3-2015 :

Expenditure	Rs.	Income	Rs.
Salary to Staff	30,000	Consultation fees	1,25,000
Rent of Dispensary	15,000	Visiting fees	25,000
Income Tax	9,250	Sale of Medicines	20,000
Laboratory Expenses	15,000	Rent from house property	30,000
Purchase of Medicines	11,250	Gifts from patients etc.	10,000
Car Expenses	9,000	Profit on sale of car	5,750
Membership Fees	500	Interest on debentures	
Municipal Taxes paid	3,000	of ABC Co. Ltd. (Gross)	5,000
(on house property)			
Printing Charges	1,000		
Repairs	6,500		
Charity	375		
Sundry Expenses	1,875		
Donations	3,000		
Surplus for the Year	1,15,000		
	2,20,750		2,20,750

Compute the total income for the assessment year 2015-16 after taking into consideration the following information :

(a) There was no stock of medicines as on 31-3-2015.

(b) Gifts included Rs. 2,500 received from his relatives in personal capacity.

(c) Repairs related to house property let out.

(d) Car was purchased in 2003 and there was no other asset in that block of assets. The written down value of car on 1-4-2014 was Rs. 37,500.

(e) The car was used entirely for profession.

(f) Depreciation on the block of assets other than car amounted to Rs. 11,250 allowable as per rules.

(g) Donations are paid to Fund for Techonology Development and Application.

Solution

Computation of the Total Income of Medical Practitioner for A. Y. 2015-16

Particulars	Rs.	Rs.	Rs.
(I) Income from Profession :			
Surplus as per income & Expenditure A/c	1,15,000		
Add : Expenses disallowed :			
Income tax	9,250		
Municipal taxes on H. P.	3,000		
Repairs to house property	6,500		
Charity	375		
Donations	3,000	22,125	
		1,37,125	
Less : Incomes taxable under other heads :			
Rent from house property	30,000		
Gifts in personal capacity	2,500		
Profit on sale of car	5,750		
Interest on debentures of ABC Ltd.	5,000	43,250	
		93,875	
Less : Depreciation as per rules		11,250	82,625
(II) Income from House Property			
Gross Annual Value :			
Rent received		30,000	
Less : Municipal taxes paid		3,000	
Annual Value		27,000	
Less : (1) Standard deduction (30% of A.V.)	8,100	8,100	18,900
(III) Income from other Sources :			
Interest on Debentures of ABC Ltd.			5,000
(IV) Short-term capital gain			5,750
Gross Total Income			1,12,275
Less : Deduction for Donations u/s 80 G			3,000
Total Taxable Income			**1,09,275**

*[**Notes : 1.** No depreciation is chargeable on car sold.*

***2.** Gift received in personal capacity is tax-free as is less than Rs. 50,000.]*

Illustration 7 : Shri. Shankar is engaged in smuggling business out of which he earned a profit of Rs. 20,000. This profit is arrived at after claiming the following expenses :

(a) Rs. 3,000 paid as tips to border police.

(b) Rs. 5,000 as loss of goods seized by the custom authority.

(c) Rs. 2,000 paid as penalty to the Customs Department.

He is also carrying on regular cloth business from which he made a profit of Rs. 50,000.

His other incomes are :

(i) Winning from horse race Rs. 2,000, winning from lotteries Rs. 5,000 and winning from bridge game Rs. 1,000.

(ii) He received a royalty of Rs. 15,000 in respect of a book written by him and he claims expenditure of Rs. 3,000 in preparing its manuscript and Rs. 2,000 paid to a student who collected the material for the book.

(iii) He received remuneration of Rs. 1,500 for delivering guest lectures.

(iv) He received Rs. 790 as dividend on shares of a foreign company and Rs. 3,500 as income from agricultural land in Bangladesh.

(v) He earned interest at 15% on deposit of Rs. 5,000 with Bajaj Auto Ltd.

Shri. Shankar has spent Rs. 25,000 for medical treatment of his son suffering from specified disease.

Compute his total income for the A. Y. 2015-16.

Solution

Computation of the Total Income of Shir. Shankar
for A. Y. 2015-16

Particulars	Rs.	Rs.	Rs.
(I) Income from Business :			
Smuggling business profit		20,000	
Add : Penalty to customs dept.		2,000	
		22,000	
Add : Income from cloth business		50,000	72,000

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(II) Income from other Sources :			
(A) Casual Incomes :			
Winning from horse race	2,000		
Winning from lotteries	5,000		
Winning from bridge games	1,000		
		8,000	
(B) Royalty of books received	15,000		
Less : Incidental expenses for -			
1. Preparing manuscript	(-)3,000		
2. Collection of materials	(-)2,000	10,000	
(C) Remuneration for guest lectures		1,500	
(D) Dividend on shares of Foreign Co.		790	
(E) Agricultural Income in Bangladesh		3,500	
(F) Interest on deposits with Bajaj Auto Ltd. (15% on Rs. 5,000)		750	24,540
Gross Total Income			96,540
Less : Deduction for treatement of son u/s 80 DDB		25,000	
Deduction for Royalty u/s 80 QBB		10,000	35,000
Total Taxable Income			**61,540**

***[Notes : 1.** It is assumed that winning from horse rece, lottery are gross receipts.*

***2.** Tips to police and loss on goods seized are allowable expenses of smuggling business.*

***3.** Agricultural income from foreign land is taxable.]*

Illustration 8 : From the following particulars of income of Mr. Chandru, Compute his total income for the assessment year 2015-16.

1. Net profit from business Rs. 32,000 after charging :
   - (a) Loss of cash kept on the house Rs. 7,000.
   - (b) Compensation paid on termination of service of a clerk on the advice of his wife Rs. 10,000.
   - (c) Gratuity paid to the widow of deceased employee Rs. 10,000 (There was no approved gratuity fund in his organisation.)

2. The annual value of his self-occupied house is Rs. 12,000 on which he has paid Rs. 2,000 as local taxes and Rs. 75 as insurance premium.

3. He owns a cinema theatre which he has let out along with machinery and furniture therein to distributors for an annual rent of Rs. 96,000 for building, Rs. 60,000 for furniture and Rs. 24,000 for machinery. The expenses incurred by him are :

   Municipal taxes Rs. 15,000, Insurance Rs. 6,000.

   The depreciation allowance is Rs. 10,000.

4. He has earned interest on bank deposits Rs. 8,000 and on deposits with a private company Rs. 10,000.

5. Insurance commission earned by him on the agency of Life Insurance Corporation is Rs. 24,000 on his gross business.

6. His gross winning from horse race are Rs. 75,000 and from card games Rs. 12,000.

7. He has paid donations to Prime Minister's National Relief Fund Rs. 5,000; Notified Gurudwara Rs. 20,000 and an approved mosque Rs. 20,000.

8. He has purchased NSC (VIIIth issue) Rs. 5,000 & Contributed Rs. 3,000 to P.P.F.

Solution

Computation of the Total Income of Mr. Chandru for A. Y. 2015-16

Particulars	Rs.	Rs.	Rs.
(I) Income from Business :			
Net Profit		32,000	
Add : Expenses disallowed :			
Loss of cash kept. in house	7,000		
Compensation to cleark on termination on wife's advice	10,000		
Gratuity payment (unapproved)	10,000	27,000	59,000
(II) Income from House Property			
Annual Value of self-occupied house			NIL

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(II) Income from other Sources :				
(a) Rent of theather - for Building		96,000		
- For Furniture		60,000		
- For Machinery		24,000		
		1,80,000		
Less : Allowable expenses :				
Municipal Taxes	15,000			
Insurance	6,000			
Depreciation allowable	10,000	31,000	1,49,000	
(b) Interest on bank deposits			8,000	
Interest on company deposits			10,000	
(c) Insurance Commission for LIC		24,000		
Less : Deduction @ 1/3rd of commi.		8,000	16,000	
(d) Casual Incomes :				
Winning from horse race		75,000		
Winning from card games		12,000		
			87,000	2,70,000
Gross Total Income				3,29,000
Less : 1. Deduction for P.P.F. & NSC u/s 80C		8,000		
2. Deduction for donations u/s 80 G		Q. Amt.		
(a) National Relief Fund		5,000		
(b) Notified Gurudwara	20,000			
Notified Mosque	20,000			
	40,000			
(Not exceeding 10% of adjusted G.T.I. Rs. 3,21,000 (*i.e.* 3.29,000 - 8000)		32,100		
		37,100		
Deduction Amount				
100% of Rs. 5,000 = 5,000				
50% of Rs. 32,100 = 16,050			21,050	29,050
Total Taxable Income				**2,99,950**

3.5 Self Assessment Questions

1. Explain in brief the procedure for computation of the total Income of an individual.

2. How would the following items be treated in the computation of the total income of an individual ?

   (a) Share in the profits of a firm.

   (b) Income received as a member of H.U.F.

   (c) Share in the profits of an Association of Persons.

   (d) Profit on sale of Capital assets.

   (e) Interest and salary from a firm of which the assessee is a partner.

   (f) Dividend from Indian Company and Foreign Company.

   (g) Interest on debentures of Company.

   (h) Winning from horse race.

   (i) Winning from lottery.

Problems for Practice

(1) Following is the Trading and Profit & Loss A/c of Mrs. Sheshadri for the year ended 31-3-2015.

Particulars	Rs.	Particulars	Rs.
To Opeing Stock	1,32,000	By Sales	14,20,000
To Purchases	13,20,000	By Closing Stock	2,48,000
To Gross Profit	2,16,000		
	16,68,000		16,68,000
To Salaries	86,400	By Gross Profit	2,16,000
To Rent	25,800	By Income from specified	
To Entertainment	20,000	Govt. Securities	18,000

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To Insurance of employees	2,890	By Amount received under	
To Printing & Stationery	4,700	Keyman Insurance	
To Advertisement	7,210	policy	66,000
To Drawings	36,000		
To Net Profit	1,17,000		
	3,00,000		3,00,000

Additional Information :

(a) Salaries include Rs. 18,000 paid as salary to Mrs. Sheshadri and Rs. 3,000 paid to domestic servant.

(b) Rent included Rs. 4,800 hostel charges of Mrs. Sheshadri's daughter.

(c) Mrs. Sheshadri owns a house property which has been self occupied. Municipal taxes Rs. 2,400 paid annually on this property are included in drawings.

(d) Drawings also included Rs. 3,800 being the amount paid into public provident fund A/c with State Bank of India.

(e) She gave a donation of Rs. 5,000 to National Foundation for Communal Harmony.

(f) Purchases include Rs. 5,000 being the cost of goods utilised by her for personal purpose.

Compute her total income for A. Y. 2015-16.

[Ans. : *Total Taxable Income Rs. 1,78,800 (GTI Rs. 1,83,800 - Rs. 5000)*
Income from Business Rs. 1,65,800 (i.e. 1,17,000 + 66,800 - 18,000);
Income from other sources Rs. 18,000; Deduction u/s 80 (G) Rs. 5,000.

Notes : ***1.*** *Disallowable businee expenses are - Salary Rs. 21,000, Hostel expenses Rs. 4,800, Purchases Rs. 5,000 & Drawings Rs. 36,000.*

2. *Amount received on Keymans's Insurance policy is taxable business income.* ***]***

(2) From the following summary of cash book of Dr. Desai, a medical practitioner, Compute his total income for the assessment year 2015-16.

Particulars	Rs.	Particulars	Rs.
Balance b/d	1,500	Cost of Medicines	8,600
Visiting fees	10,000	Presonel expenses	16,200
Receipts from blood bank	4,000	Laboratory expenses	2,800
Consultation fees	12,000	Books for profession	
Sale of medicines	6,000	(Annual)	4,000
Gift and presentst	2,000	Rent of dispensary	4,800
Rent from house property	5,000	Municipal Taxes	500
Remuneration for articles		Motor car expenses	3,200
published in journals	1,000	Income-tax	2,400
Interest on foreign securities	7,500	Wealth-tax	1,800
Interest on debentures of		Gift to wife	2000
X Co. Ltd. (Gross)	2,500	Salary to staff	2,200
		Life Insurance premium	500
		Balance b/d	2,500
	51,500		51,500

Other Information :

(a) Half of car expenses were for private use.

(b) Life insurance premium paid was on the policy of his minor son.

(c) Salary to staff includes Rs. 200 paid to a servant who is working in doctor's house.

(d) Municipal taxes paid were on house property.

(e) Gifts and presents are from his relatives on birthday celebration.

[Ans. : *Gross Total Income Rs. 22,350; Income from profession Rs. 8,200 (i.e. 32,000-23,800); Income from H.P. Rs. 3,150, Income from other sources Rs. 11,000, Taxable Income Rs. 21,850.*

Notes : ***1.*** *Gifts and presents from relatives are non-taxable.* ***2.*** *100% depreciation is allowable on books.* ***3.*** *Salary to personal servant is inadmissible.* ***4.*** *Insurance premium paid on life of minor child is deductable u/s 80 C.* ***]***

3 Dr. Anand Reddy, a medical practitioner and a lecturer in a medical college, gives you his Receipts and Payments Account for the year ended 31-3-2015 as follows :

Receipts	Rs.	Payments	Rs.
Cash balance b/d	11,640	Rent of Clinic	14,000
Consulting fees	1,80,430	Professional Travelling	3,360
Salary from Medical College	48,000	Purchase of Professional Books (Annuals)	3,980
Life Insurance policy maturity	25,000	Salary to Staff	64,000
Dividend from TELCO Ltd. (Gross)	2,700	Collection Charges (Dividends)	70
Dividend fro U.T.I. (Gross)	4,200	Clinical Expenses	4,400
Interest on deposits with		Surgical equipments	37,000
S.B.I.	3,700	Housing Loan :	
Interest on deposits with		Principal	10,000
Co-op. Banks	3,530	Interest	8,000
		House Tax	3,000
		Purchase of NSC	30,000
		Contribution to PPF	27,000
		Household expenses	47,510
		Balance C/d	30,880
	2,79,200		2,79,200

1. Depreciate surgical equipments by 15%.

2. Dr. Reddy purchased a flat on 15-3-2004. He had taken loan of Rs. 3,00,000 from H.D.F.C. Ltd. for purchasing the flat in which he resides. The annual letting value of this flat is Rs. 35,000.

3. Dr. Reddy paid Rs. 200 p.m. as professional tax against salary.

You are required to compute the total taxable income of Dr. Reddy for assessment year 2015-16.

[Ans. : *Total taxable Income Rs. 66,970, i.e. G.T.I. Rs. 1,29,970 - 63,000 Deduction 80 C Income from salary Rs. 45,600 (i.e. 48,000 - 2,400); Income from property self-occupied Rs. (-) 8,000 (NIL-8,000); Income from Profession Rs. 85,140 (1,80,430 - 95,290); Income form other sources Rs. 7,230 (3,700 + 3,530).*

Notes : ***1.*** *LIC maturity receipt is exemt u/s 10 (10D).* ***2.*** *Assessee can claim tax deduction u/s 80 C in respect of NSC, PPF and housing loan principal.* ***3.*** *Dividend of UTI and Telco are exempt u/s 10 (35) and 10 (34) respectively.]*

(4) The following is the Income and Expenditure Account of Mrs. Smita for the year ending 31-3-2015.

Expenditure	Rs.	Income	Rs.
Salary to staff	42,000	Consultation fees	1,70,000
Laboratory expenses	36,000	Visiting fees	57,180
Rent of consulting room	26,000	Gifts from patients	4,000
Purchase of Medicines	14,500	Sale of Medicines	18,000
Income-tax	8,500	Rent from house property	36,000
Car expenses	23,640		
Membership fees	310		
Municipal Tax on house	3,600		
Repairs	1,800		
Printing Charges	2,400		
Charity & donations	11,500		
Sundry expenses	4,750		
Surplus for the year	1,10,180		
	2,85,180		2,85,180

Compute her taxable income for the A.Y. 2015-16 after taking into consideration the following information :

(a) Charity of Rs. 1,500 is the cost of medicine given to a poor student and a donation of Rs. 10,000 to Maharashtra State Blood Transfusion Council.

(b) She incurred the expenses Rs. 25,000 on medical treatment, training and rehabilitation of severely a physically handicapped sister depending only on her and deposited Rs. 10,000 under the scheme of LIC for her maintenance.

(c) Gifts includes Rs. 1,000 from her relatives in personal capacity.

(d) There was no stock of medicines at the of the year.

(e) The car was used entirely for profession.

(f) Repairs related to house property.

(g) Depreciation on motar car, surgical equipment and furniture allowable as deduction under Income-tax Rules Rs. 14,500.

[Ans. : *Total Income Rs. 46,760; G.T.I. Rs. 1,06,760, Deductions - 80 DD Rs. 50,000 and 80 G Rs. 10,000, Income from Profession Rs. 84,080 (i.e. 1,10,180 + 25,400 - 37,000 - 14,500), Income from House property Rs. 22,680 (i.e. 36,000 - 3600 - 9,720).*

Notes : ***1.*** *Charity to poor students is not eligible for deduction u/s 80 G.* ***2.*** *Gifts received in personal capacity is tax-free as are below Rs. 50,000.* **]**

5) From the following particulars furnished by Shri. Jagdish. Compute his total income for A. Y. 2015-16 and the qualifying amount for deduction u/s 80 C :

Winning from Goa Lottery	10,000
Winning from Card Games	2,000
Loss from self-occupied house property	2,000
Salary (gross)	36,000
Director's sitting fees	7,000
Factory building with machinery let out :	
Rent received	40,000
Repairs	5,000
Insurance	2,000
Interest on Loan	5,000
Royalty received on books	2,000
Royalty received on patent rights	5,000
Interest on government securities	15,000
Payments and Investments :	
National Savings Certificates (VIIIth issue)	10,000
Education Fees of two children	5,000
Donation to an unapproved institution	5,000
Repayment of Loan instalments borrowed from 'canfun' of Canara Bank for construction of house	25,000

(conted. on next page)

Donation to an approved local authority for promoting family planning programme	5,000
Deposit in 10 years Post office Cumulative Time Deposit Accounts	2,000
Insurance Premium paid by chequre on the health of his child under mediclaim scheme	1,000
Life Insurance premium paid on his life Policy of Rs. 50,000	5,000

[Ans. : *Total Income Rs. 45,000; G.T.I. Rs. 1,03,000; Deductions u/s 80 D Rs. 1,000 u/s 80 G Rs. 5,000 (100%) and u/s 80 C Rs. 47,000; u/s 80 QQB Rs. 5,000. Income from salary Rs. 36,000.*

Income from House property (S.O.P.) (-) Rs. 2,000, other sources Rs. 69,000 (i.e. 10,000 + 2,000 + 7,000 + 28,000 + 2,000 + 5,000 + 15,000).

Qualifying amount for deduction u/s 80 C Rs. 47,000 (i.e. 5,000 + 25,000 + 2,000 + 10,000 + 5,000). ***]***

3.6 Further Readings

1. Students Guide to Income Tax - V. K. Singhania.
2. Direct Tax Law - Dinkar Pagare

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Unit-4
Introduction to Service Tax

Structure

4.0 Objectives :

After studying this unit, you should be able to understand -

- the concept of Service Tax
- services forming part of negative list
- how the value of taxable service is determined
- the rate of service tax
- who is liable to pay service tax
- the concept of VAT
- the procedure of online tax payment
- the procedure of filing income tax return.

4.1 Introduction :

Taxation is the main source of obtaining funds to the Government. There are two different views regarding increasing the funds from taxes. One is to raise the tax rate of current taxes and another is to find out new areas of taxation and to bring more and more people under the tax net. In the age of LPG it would not be feasible to increase the tax rate so the Government has chosen the second way that is to introduce new taxes. So Service Tax was introduced for the first time in India in 1994 under the Finance Act of 1994.

There is another reason to introduce Service Tax in India and that is, increasing importance of service sector in Indian economy. Share of service sector increased from 28% of GDP in 1950 to about 70% of GDP in 2010.

4.2 Subject Matter

4.2.1 Service Tax in India :

The Tax Reforms Committee headed by Dr. Raja Chelliah recognized the revenue potential of the service sector in India and recommended introduction of Service Tax on select services. On the basis of these recommendations Dr. Manmohan Singh, the then Union Finance Minister, introduced the new concept of Service Tax under Chapter V of the Finance Act, 1994.

Service Tax is a tax levied on notified services provided or to be provided in India, except in the State of Jammu and Kashmir. It is chargeable on providing service or services but payable only on receipt of taxable service from the customer or client before, during or after rendering the services. It is an indirect tax.

The service tax was introduced in India in 1994. From the beginning till today the number of services as well as the revenue from service tax has been constantly increased. The tax collections have grown substantially since from Rs. 410 crores in 1994-95 to Rs.132518 crores in 2012-13. The total number of taxable services also increased from 3 in 1994 to 119 in 2011-12.

The following table shows the revenue from service tax, number of services and number of assessees from 1994-95 to 2012-13.

Financial Year	Revenue Rupees (in crores)	Number of services	Number of Assessees
1994-1995	407	3	3943
1995-1996	862	6	4866
1996-1997	1059	6	13982
1997-1998	1586	18	45991
1998-1999	1957	26	107479
1999-2000	2128	26	115495
2000-2001	2613	26	122326
2001-2002	3302	41	187577
2002-2003	4122	52	232048
2003-2004	7891	62	403856
2004-2005	14200	75	774988
2005-2006	23055	84	846155
2006-2007	37598	99	940641
2007-2008	51301	100	1073075
2008-2009	60941	106	1204570
2009-2010	58422	109	1307286
2010-2011	71016	117	1372274
2011-2012	97509	119	1535570
2012-2013	132518	Negative List Regime	1712617

The approach used for levying tax on services was selective approach. However, from 1 July 2012 the concept of taxation on services was changed from a 'Selected service approach' to a 'Negative List regime'. This changed the taxation system of services from tax on some Selected services to tax being levied on the every service other than services mentioned in Negative list.

4.2.2 Services forming part of Negative List:

The negative list shall comprise of the following services:

(a) services by Government or a local authority excluding the following services to the extent they are not covered elsewhere— (i) services by the Department of Posts by way of speed post, express parcel post, life insurance and agency services provided to a person other than Government; (ii) services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport; (iii) transport of goods or passengers; or (iv) support services, other than services covered under clauses (i) to (iii) above, provided to business entities;

(b) services by the Reserve Bank of India;

(c) services by a foreign diplomatic mission located in India;

(d) services relating to agriculture by way of— (i) agricultural operations directly related to production of any agricultural produce including cultivation, harvesting, threshing, plant protection or testing; (ii) supply of farm labour; (iii) processes carried out at an agricultural farm including tending, pruning, cutting, harvesting, drying, cleaning, trimming, sun drying, fumigating, curing, sorting, grading, cooling or bulk packaging and such like operations which do not alter the essential characteristics of agricultural produce but make it only marketable for the primary market; (iv) renting or leasing of agro machinery or vacant land with or without a structure incidental to its use; (v) loading, unloading, packing, storage or warehousing of agricultural produce; (vi) agricultural extension services; (vii) services by any Agricultural Produce Marketing Committee or Board or services provided by a commission agent for sale or purchase of agricultural produce;

(e) trading of goods;

((f) any process amounting to manufacture or production of goods;

(g) selling of space or time slots for advertisements other than advertisements broadcast by radio or television;

(h) service by way of access to a road or a bridge on payment of toll charges;

(i) betting, gambling or lottery;

(j) admission to entertainment events or access to amusement facilities;

(k) transmission or distribution of electricity by an electricity transmission or distribution utility;

(l) services by way of— (i) pre-school education and education up to higher secondary school or equivalent; (ii) education as a part of a curriculum for obtaining a qualification recognised by any law for the time being in force; (iii) education as a part of an approved vocational education course;

(m) services by way of renting of residential dwelling for use as residence;

(n) services by way of— (i) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount; (ii) inter sale or purchase of foreign currency amongst banks or authorised dealers of foreign exchange or amongst banks and such dealers;

(o) service of transportation of passengers, with or without accompanied belongings, by— (i) a stage carriage; (ii) railways in a class other than— (A) first class; or (B) an air-conditioned coach; (iii) metro, monorail or tramway; (iv) inland waterways; (v) public transport, other than predominantly for tourism purpose, in a vessel of less than fifteen tonne net; and (vi) metered cabs, radio taxis or auto rickshaws;

(p) services by way of transportation of goods— (i) by road except the services of— (A) a goods transportation agency; or (B) a courier agency; (ii) by an aircraft or a vessel from a place outside India to the first customs station of landing in India; or (iii) by inland waterways;

(q) funeral, burial, crematorium or mortuary services including transportation of the deceased.

4.2.3 Value of Taxable Service :

As service tax is to be charged on the value of taxable service provided or to be provided, it is necessary to know how the value of taxable service is to be determined.

As per section 67, the valuation of taxable service shall be determined under the following two situations -

a) Service tax is separately charged in the Bill.

b) Service tax is included in the Bill Value.

Service tax is separately charged in the Bill :

The valuation of taxable service is depending on the type of consideration of service. It is explained as follows -

i) Whether the provision of service is for a consideration in money:

Gross amount charged by the service provider in the bill is the value of taxable service.

ii) Whether the provision of service is for consideration partly in money and partly in kind or wholly in kind:

The amount of money and the market value of consideration received in kind is the value of taxable service.

iii) Whether the provision of service is for a consideration which is not ascertainable:

The valuation of taxable service shall be the amount to be determined in prescribed manner.

Service tax is included in the Bill Value:

If the gross amount charged by a service provider is inclusive of service tax payable, the value of such taxable service shall be determined by deducting the amount of service tax from the gross amount charged. In this situation the service tax is calculated on the basis of reverse working.

4.2.4 Charging Service Tax :

Section 66 is the charging section of the Act and provides as under -

i) Service tax is charged @ 10% of gross value of taxable service, but in certain cases, abatement is provided for material component of the transaction.

Though service tax is levied at the basic rate of 10 %, in certain cases an alternative rate is also provided.

ii) An Education Cess @ 2 % is to be charged on the service tax on all taxable services vide the Finance No. (2) Act, 2004 with effect from 10/09/2004.

iii) The Secondary and Higher Education Cess (SHEC) @ 1% shall also be charged on the service tax on all taxable services vide the Finance Act, 2007 with effect from 11/05/2007.

Thus, the current rate of service tax is 10% of the gross value of service plus education cess @ 2% of the service tax and SHEC @ 1% of the service tax.

iv) The tax is levied only on those taxable services which are referred to in various sub-clauses of clause (105) of section 65. There is no tax on free services.

v) There is no particular definition of taxable service/s. Taxable services means those services which are included in various sub clauses of section 65 (105). The following are the some of the essential characteristics of services -

a) existence of two parties - service provider and service recipient.

b) service as distinct to sale

c) service provided should be a taxable service

d) consideration for the service

vi) There are also certain exemptions from service tax.

Rate of Service Tax :

The rate of service tax from the introduction was as follows:

i) The rate of service tax was 5% on gross value of taxable service, from 01/07/1994 to 13/05/2003.

ii) The rate of service tax was 8% on gross value of taxable service, from 14/05/2003 to 09/09/2004.

iii) The rate of service tax was 10% on gross value of taxable service and education cess was at 2% of the service tax, from 10/09/2004 to 17/04/2006.

iv) The rate of service tax was 12% on gross value of taxable service and education cess was at 2% on the service tax, from 18/04/2006 to 10/05/2007.

v) The rate of service tax was 12% on gross value of taxable service; education cess was at 2% on the service tax and SHEC at 1% on the service tax, from 11/05/2007 to 23/02/2009.

vi) The rate of service tax was 10% on gross value of taxable service; education cess was at 2% on the service tax and SHEC at 1% on the service tax, from 24/02/2009 to 31/03/2012.

vii) The rate of service tax was 12% on gross value of taxable service; education cess was at 2% on the service tax and SHEC at 1% on the service tax, from 01/04/2012 onwards.

4.2.5 Person who has to pay Service Tax :

The service tax is required to pay as per the provisions of rule 6 of the Service Tax Rules, 1994. The general principle is that the person providing a taxable service is liable to pay service. In certain specific situations, section 68(2) permits the government to notify person other than the person providing the taxable service to be liable for payment of service tax. The exceptions to general principle are as fallows.

Sr. No.	Services	Persons liable for Payment
1	General Insurance	Insurance Company
2	Insurance Auxiliary	Insurance Company
3	Any service provided from outside India and Received in India	Receiver of service in India
4	Goods Transport Agency (GTA)	Person making payments of freight I.e. receiver of the service in organized sector or GTA i.e. provider of service in other case
5	Sponsorship Services	Person sponsoring the event if he is located in India
6	Business auxiliary services of distribution of mutual fund	Mutual fund

4.2.6 Concept of Value Added Tax (VAT) :

Value Added Tax (VAT) is a broad based tax levied of multiple stage with tax on inputs credited against taxes on output VAT was firstly introduced in the 1950's but it remained confined to handful number of countries till the 1980's .As many as 30 Countries have switched over to VAT since 1980 and the total number of countries who have adopted VAT presently reached to more than 130. India has been slow in adoption of VAT. In domestic trade taxes, it adopted excise duty at the Central level and sales tax at State level for this purpose.

The Central Government attempted reforms in the central excise duty by introducing the principles of VAT in 1986 through the introduction of MODVAT. Over the period the rates have been rationalized exemption have been reduced and coverage has been extended to almost all the commodities commencing MODVAT has now been converted into a central VAT coined and called CENVAT.

The state Government had been indifferent in understanding any reforms in the sales tax system .The task force known as Kelkar Committee was appointed to study this issue and it opinioned that it is necessary that state VAT should be the tax to unify all the state level taxes i.e. Sales Tax, Purchase Tax, Turnover Tax, Work Contract Tax, Entry Tax, Special Additional Tax etc. should all be covered under State VAT. The efforts were initiated towards introduction of VAT since last many years.

VAT is a Tax, which is charged on the increase in value of goods and services at each stage of production and circulation. It is also chargeable on the value of all imported goods. It is charged by registered VAT business/ persons/ Tax payers. VAT has replaced a number of other taxes and its introduction has not resulted in either increased prices to final consumers or reduced profitability of business. VAT is levied on the difference between the sale price of the goods produced on the services rendered and the cost their of that is the difference between the output and the input.

In other words -

- It is nothing but multi point Sales Tax.
- It is collected on value addition only at each stage.
- Tax paid by the dealer is deducted from the tax payable collected at every point of sale and the tax already paid

Difference between Sales Tax & VAT :

Sales Tax	VAT
1. Tax is levied at the stage of the first sale or at the final stage.	1. Tax is levied and collected at every point of sale.
2. Tax is charged on goods only.	2. Tax is charged on goods & services both.
3. A large numbers of forms are required.	3. At the most a few forms are required.
4. Computation of tax liability is complex	4. It is transparent and easier
5. Assessment is done by the department	5. Self -Assessment is done by dealer.
6. Penalties for defaulter/evaders are not strict.	6. Penalties will be stricter.
7. Dealer reselling tax paid goods do not collected any tax on resale and file nil returns.	7. Dealer reselling tax paid goods will have to collect tax &VAT, file returns and pay VAT at Every Stage of sale.
8. Sales tax is not levied at the time of purchase against statutory forms but there is misuse of such forms resulting in tax evasion.	8. VAT dispenses with such forms and sets off all tax paid at the amount of tax payable on sale
9. Returns and challans are filed separately and the dealer have to give numerous detail	9. The returns & the Challans are filed together in a simple format after self assessment done by the dealer himself.

4.2.7 e-payment of Taxes (online)

4.2.7.1 Introuction & Advantages of paying tax online:

e- payment and e-filing is new concept introduced by the Income Tax Department.

e-payment is similar to booking tickets or making payments online. All Direct Taxes e.g. Income Tax, Corporate tax, FBT, BCTT (TDS, Advance tax, self assessment tax) to be paid online using net banking facility. It has been mandatory for all Companies and 44AB cases from 1st April, 2008 to pay taxes through e-payment facility using net banking account. Credit/debit card facility is yet to be in operation.

The procedure of e-payment and e-filing is different. The said concept has been explained one by one as follows :

Advantages of paying taxes online

1. You can pay taxes from any location at any time through your net-banking account.
2. Instant transfer of funds from your account.
3. What you write on the e-challan will be directly sent to Income Tax Department. Banks will not do any data entry.
4. You can save/print the challan copy and the receipt copy.
5. As soon as your Bank authorizes payment of the amount, you will receive a clear, legible receipt/counterfoil from your Bank.
6. Transaction id of the e-payment transaction will be available to you in your bank statement.
7. You can check online if your money has actually reached the I-T Department. For this you have to go to Tax Information Network Website: https://tin.tin.nsdl.com/oltas/index.html and click the box.

4.2.7.2 e-payment of taxes

This is a facility provided to the taxpayers to make income tax payments through internet, using net-banking facility.

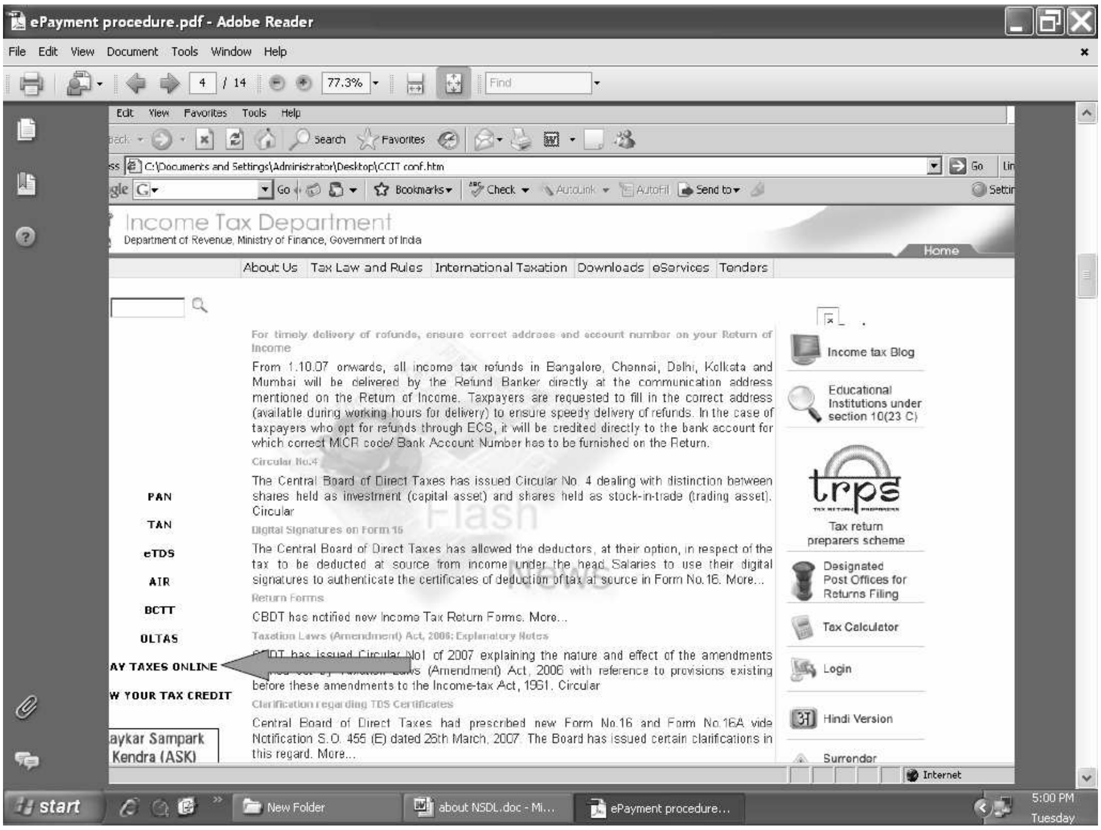
4.2.7.3 Procedure of e-payment

To e-payment of taxes :

- Taxpayer can make tax payment from any location without going to Bank branch.
- Amount of tax debited to his bank account electronically and credited to GOI.
- Log in to website of Income Tax Department : www.incometaxindia.gov.in
- Choose the button‘ pay taxes online’.

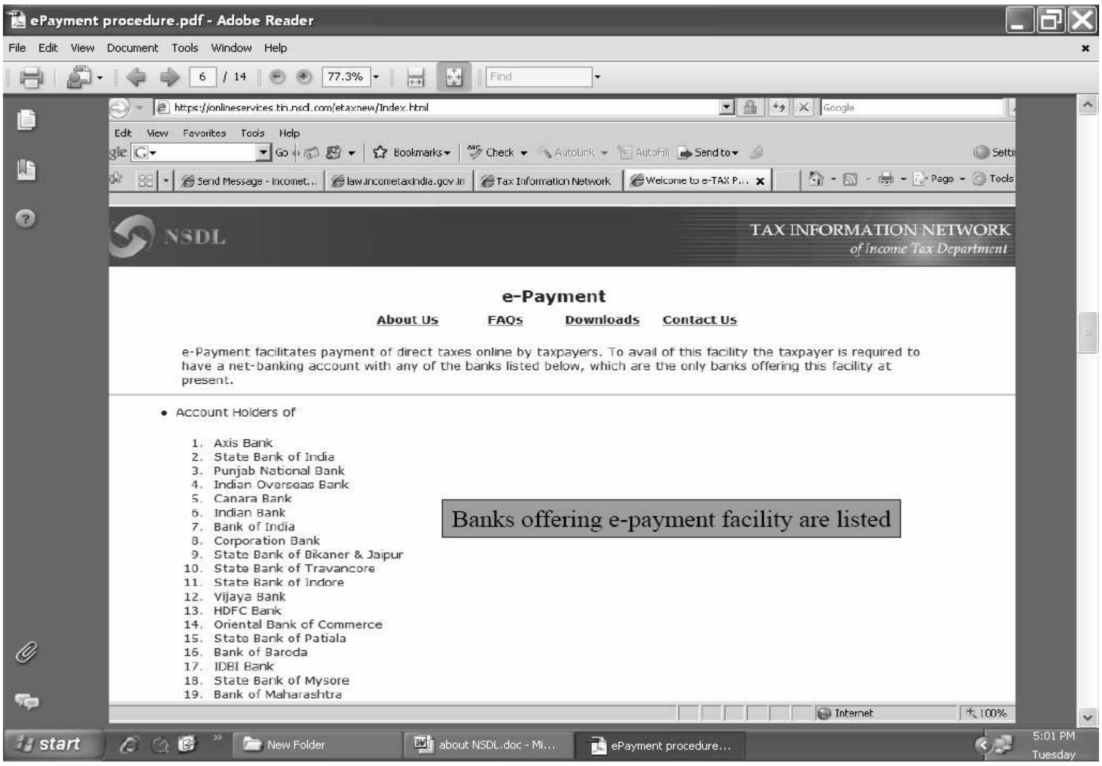
To fill the challan :

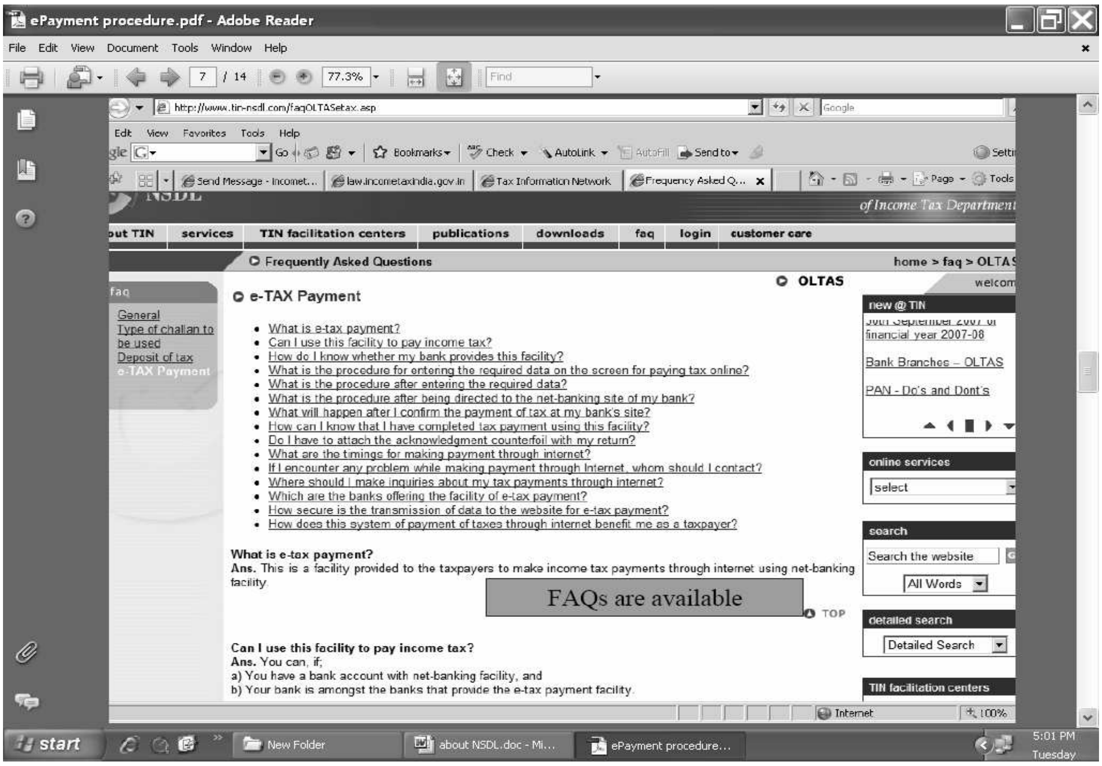
- Taxpayer is taken to Tax Information (TIN) website where all Banks offering

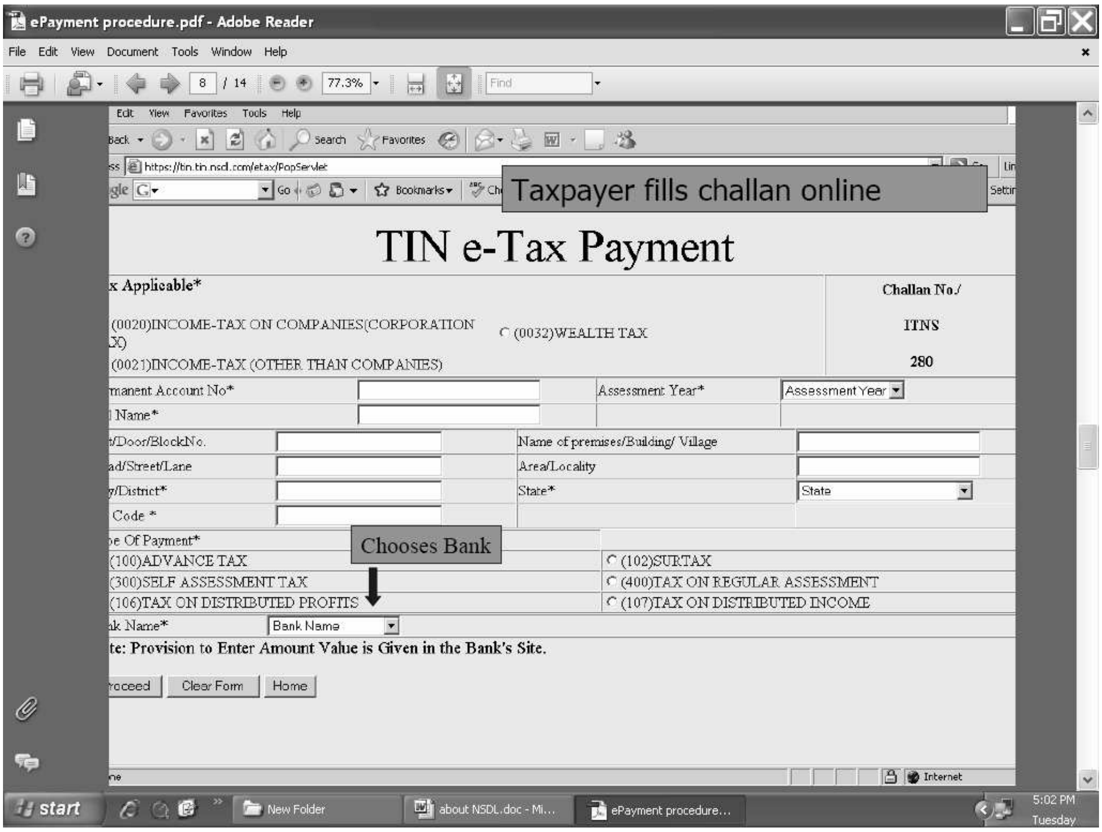


e-payment facility are listed.

- Then I choose the challan for the tax I wish to pay e.g. ITNS 281 for TDS, ITNS 280 for Income Tax etc.

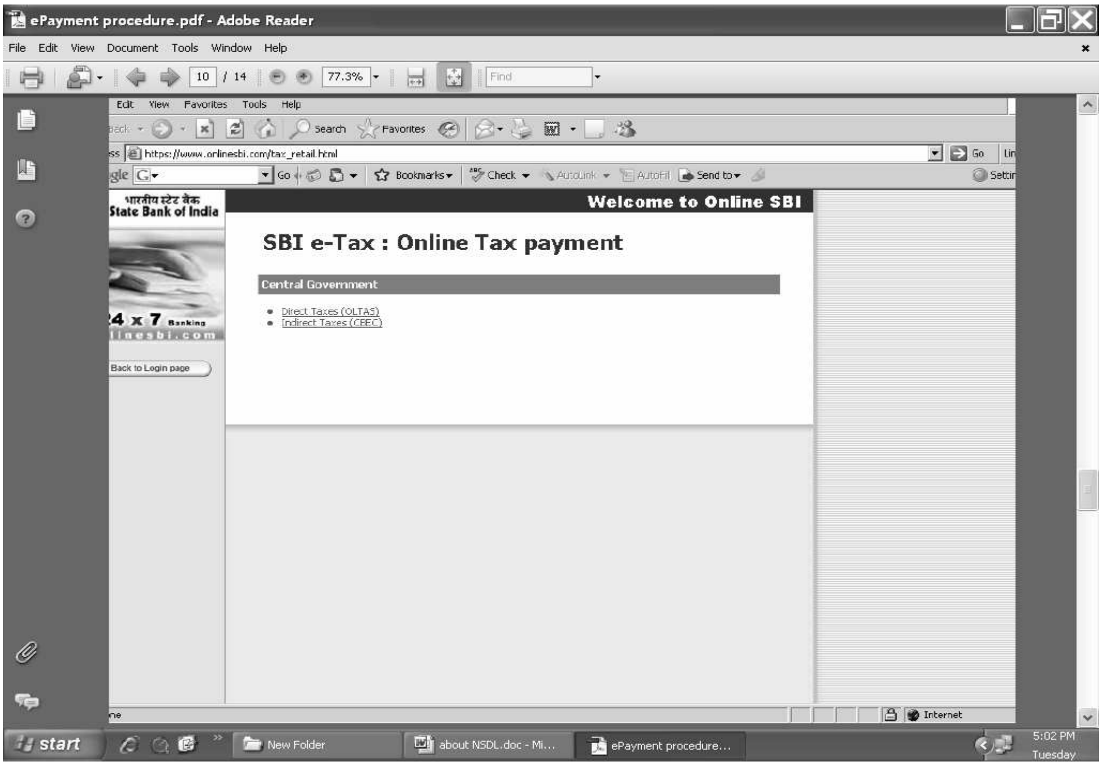

ePayment procedure.pdf - Adobe Reader
https://onlineservices.tin.nsdl.com/etaxnew/Index.html
NSDL
TAX INFORMATION NETWORK
of Income Tax Department
e-Payment
About Us
FAQs
Downloads
Contact Us
e-Payment facilitates payment of direct taxes online by taxpayers. To avail of this facility the taxpayer is required to have a net-banking account with any of the banks listed below, which are the only banks offering this facility at present.
• Account Holders of
1. Axis Bank
2. State Bank of India
3. Punjab National Bank
4. Indian Overseas Bank
5. Canara Bank
6. Indian Bank
7. Bank of India
8. Corporation Bank
9. State Bank of Bikaner & Jaipur
10. State Bank of Travancore
11. State Bank of Indore
12. Vijaya Bank
13. HDFC Bank
14. Oriental Bank of Commerce
15. State Bank of Patiala
16. Bank of Baroda
17. IDBI Bank
18. State Bank of Mysore
19. Bank of Maharashtra
Banks offering e-payment facility are listed


ePayment procedure.pdf - Adobe Reader
http://www.tin-nsdl.com/faqOLTASetax.asp
of Income Tax Department
Frequently Asked Questions
home > faq > OLTAS
OLTAS
e-TAX Payment
General
Type of challan to be used
Deposit of tax
e-TAX Payment
What is e-tax payment?
Can I use this facility to pay income tax?
How do I know whether my bank provides this facility?
What is the procedure for entering the required data on the screen for paying tax online?
What is the procedure after entering the required data?
What is the procedure after being directed to the net-banking site of my bank?
What will happen after I confirm the payment of tax at my bank's site?
How can I know that I have completed tax payment using this facility?
Do I have to attach the acknowledgment counterfoil with my return?
What are the timings for making payment through internet?
If I encounter any problem while making payment through Internet, whom should I contact?
Where should I make inquiries about my tax payments through internet?
Which are the banks offering the facility of e-tax payment?
How secure is the transmission of data to the website for e-tax payment?
How does this system of payment of taxes through internet benefit me as a taxpayer?
What is e-tax payment?
Ans. This is a facility provided to the taxpayers to make income tax payments through internet using net-banking facility.
FAQs are available
Can I use this facility to pay income tax?
Ans. You can, if;
a) You have a bank account with net-banking facility, and
b) Your bank is amongst the banks that provide the e-tax payment facility.



After filing the challan :

- The taxpayer chooses his Bank.
- At the bank website he enters his user id, password etc and completes the transaction.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भारतीय स्टेट बैंक State Bank of India
Welcome to Online SBI
SBI e-Tax : Online Tax payment
Central Government
Direct Taxes (OLTAS)
Indirect Taxes (CBEC)
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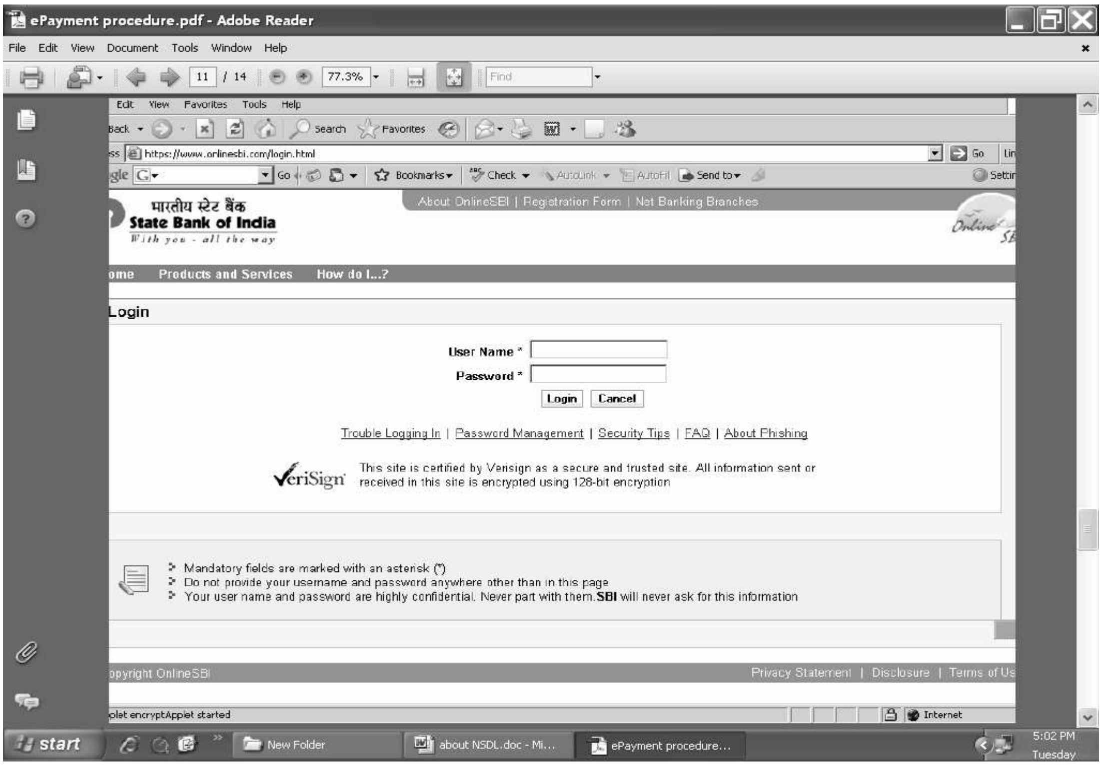
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This site is certified by Verisign as a secure and trusted site. All information sent or received in this site is encrypted using 128-bit encryption
Mandatory fields are marked with an asterisk (*)
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Your user name and password are highly confidential. Never part with them. SBI will never ask for this information
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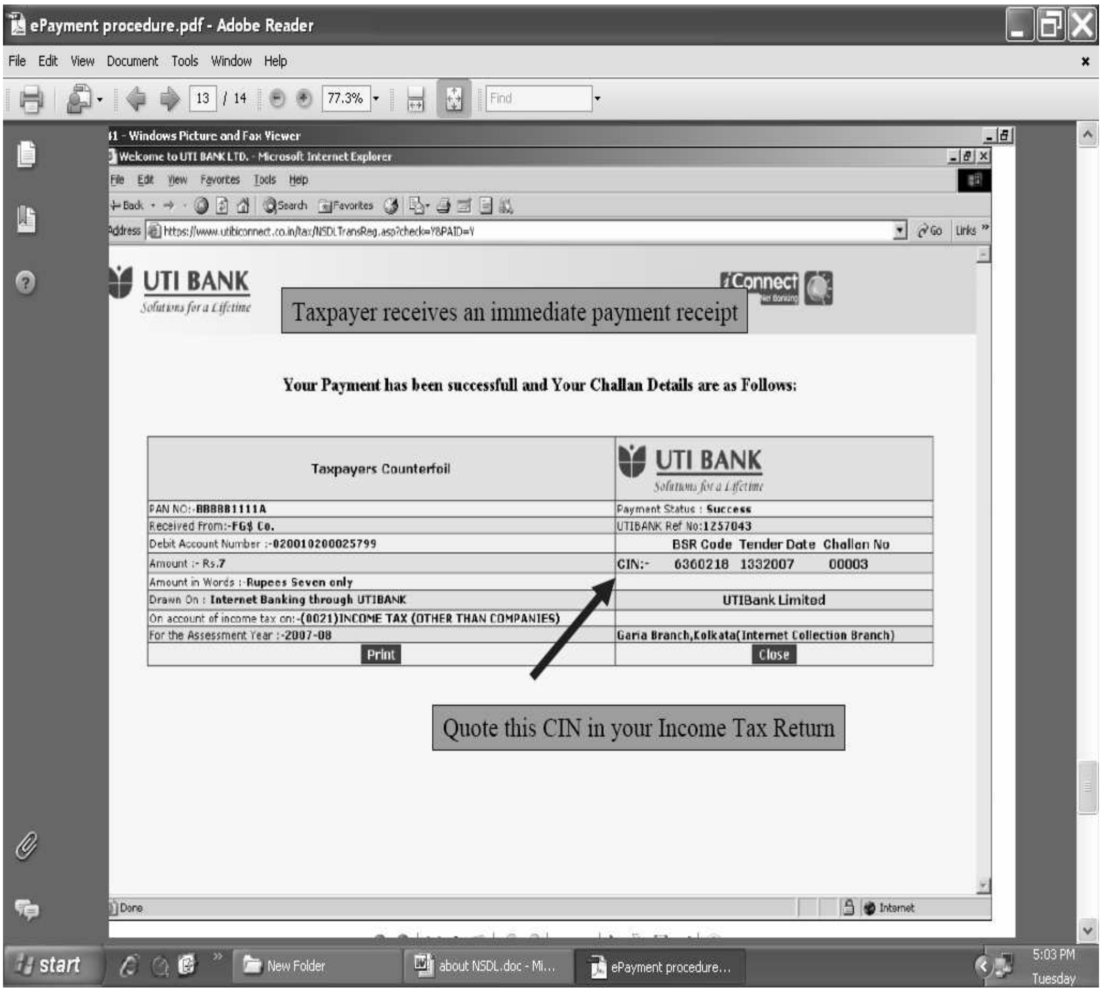
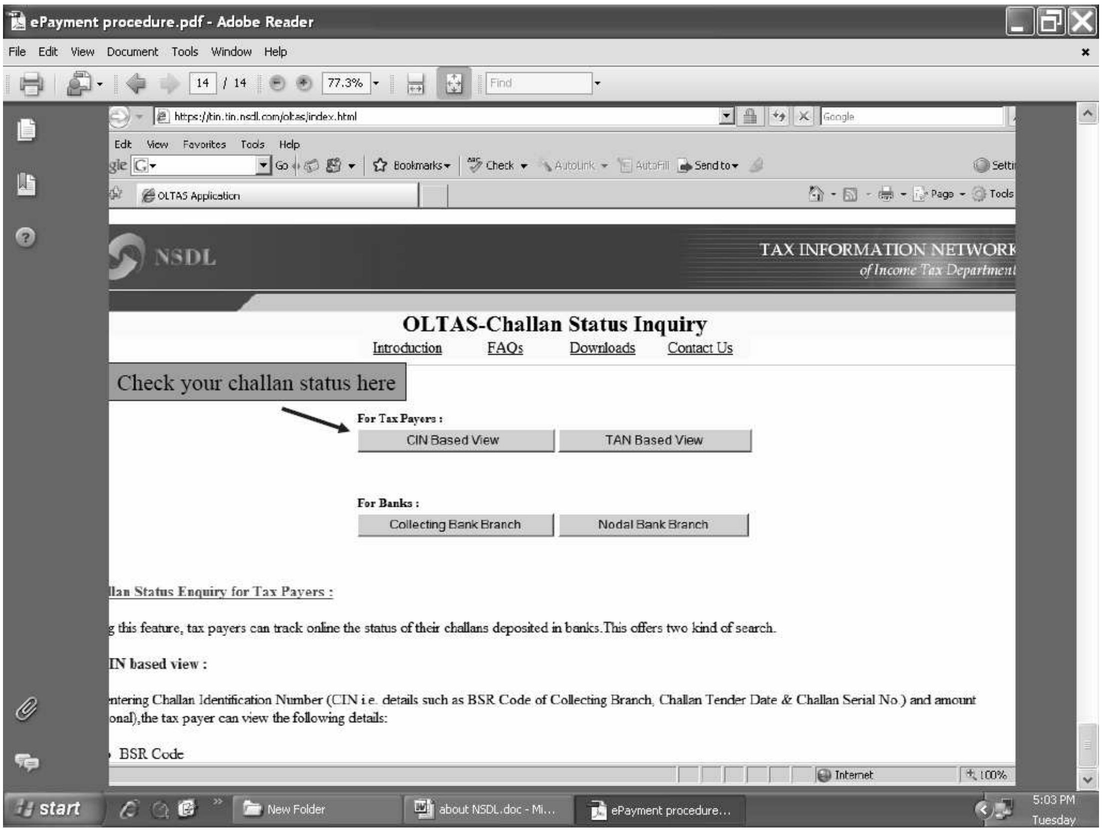
At the Bank website :

- The transaction is authorised by the Bank.
- Taxpayer receives immediate, confirmed receipt/ counterfoil of challan having a challan identification number (CIN).
- Counterfoil can be printed or saved.
- Taxpayer should quote his challan identification number (CIN) in his Income Tax Return.





4.2.7.4 Banks offering e-payment facility :

1. Axis Bank.
2. State Bank of India.
3. Punjab National Bank.
4. Indian Overseas Bank.
5. Canara Bank.
6. Indian Bank.
7. Bank of India.
8. Corporation Bank.
9. State Bank of Bikaner & Jaipur.
10. State Bank of Travancore.
11. State Bank of Indore.

12. Vijaya Bank.
13. HDFC Bank.
14. Oriental Bank of Commerce.
15. State Bank of Patiala.
16. Bank of Baroda.
17. IDBI Bank.
18. State Bank of Mysore.
19. Bank of Maharashtra.
20. State Bank of Hyderabad.
21. State Bank of Saurashtra.
22. Union Bank of India.
23. Allahabad Bank.
24. Dena Bank.
25. Syndicate Bank.
26. ICICI Bank.

4.2.7.5 Summary of e-payment of tax :

Procedure of e-payment includes

1. To pay taxes online the taxpayer will select the relevant challan i.e. ITNS 280, ITNS 281, ITNS 282 or ITNS 283, as applicable.
2. Enter its PAN / TAN as applicable. There will be an online check on the validity of the PAN / TAN entered.
3. If PAN/ TAN is valid the taxpayer will be allowed to fill up other challan details like accounting head under which payment is made, name and address of TAN and also select the bank through which payment is to be made, etc.
4. On submission of data entered a confirmation screen will be displayed. If the taxpayer confirms the data entered in the challan, it will be directed to the net-banking site of the bank.

5. The taxpayer will login to the net-banking site with the user id/ passwords provided by the bank for net-banking purpose and enter payment details at the bank site.

6. On successful payment a challan counterfoil will be displayed containing CIN, payment details and bank name through which e-payment has been made. This counterfoil is proof of payment being made.

4.2.7.6 Exercise (For check your progress)

1. What is e-payment of taxes ?

This is a facility provided to the taxpayers to make income tax payments through internet, using net-banking facility.

2. How can I use this facility to pay income tax ?

You can use the facility if -

(a) You have a bank account with net-banking facility, and

(b) Your bank is amongst the banks that provide the e- payment facility.

3. Whether it is mandatory to pay tax online ?

It is mandatory for the following types of assesses to pay tax online with effect from April 1,2008.

a) All the corporate assesses.

(b) All assesses (other than company) to whom provisions of section 44AB of the Income Tax Act, 1961 are applicable.

4. Whether it is mandatory to make the TDS/TCS payment (Challan 281) online ?

Yes, it is mandatory for below Assessee to make the TDS/TCS payment online

(a) All the corporate assesses.

(b) All assesses (other than company) to whom provisions of section 44AB of the Income Tax Act, 1961 are applicable.

5. How do I know whether my bank provide this facility ?

The list of banks providing this facility is available on NSDL-TIN website. Alternatively you may get the information from your bank.

6. **What should I do if my bank does not have an online payment facility or is not an authorized bank for e-tax ?**

In case your bank does not have an online payment facility or is not an authorized bank then you can make electronic payment of tax from the account of any other person who has an account with the authorized bank having online facility. However, the challan for making such payment must clearly indicate your Permanent Account Number (PAN).

7. **What is the procedure for entering the required data on the screen for paying tax online ?**

Follow the steps as under to pay tax online :-

Step - 1

(a) Log on to NSDL-TIN website (www.tin-nsdl.com).

(b) Click on the icon e-payment: pay taxes online.

(c) Click on 'Please Click Here'.

(d) Select the required challan.

Step - 2

After selecting the required challan, you will be directed to the screen for entering the following data:-

(a) PAN for non-TDS payments and TAN for TDS payments.

(b) Name and address of the taxpayer.

(c) Assessment Year.

(d) Major Head Code.

(e) Minor Head Code.

(f) Type of payment.

(g) Select the bank name from the drop down provided.

In case of challan no. 280, 282 and 283 the Permanent Account Number (PAN) needs to be entered. In case of challan no. 281 Tax Deduction/ Collection Account Number (TAN) needs to be entered. Please ensure that you enter PAN/TAN correctly, as this is extremely important for further processing. The system will check the validity of PAN/TAN. In case PAN/ TAN is not available in the database of the Income Tax Department then you cannot proceed with the payment of tax.

Step - 3

After entering all the above detail, click on PROCEED button. TIN system will display the contents you have entered along with the "Name" appearing in the ITD database with respect the PAN/TAN entered by you.

Step - 4

You can now verify the details entered by you. In case you have made a mistake in data entry, click on **"EDIT"** to correct the same. If all the detail and name as per ITD is correct, click on **"SUBMIT"** button. You will be directed to the net-banking site provided by your bank.

8. What is the procedure after being directed to the net banking site of the bank ?

TIN system will direct you to net-banking facility of your bank. You will have to log on to the net banking site of your bank using your login ID and password/PIN provided by the bank. The particulars entered by you at TIN website will be displayed again.

You will now be required to enter the amount of tax you intend to pay and also select your bank account number from where you intend to pay the tax. After verifying the correctness, you can proceed with confirming the payment.

9. What will happen after I confirm the payment of tax at my bank's site ?

Your bank will process the transaction online by debiting the bank account indicated by you and generate a printable acknowledgment indicating the **Challan Identification Number (CIN)**. You can verify the status of the challan in the "Challan Status Inquiry" at NSDL-TIN website using CIN after a week, after making payment.

10. How can I know that I have completed tax payment using this facility ?

Apart from CIN given to you, you can check your online bank statement to verify the tax payment.

11. Do I have to attach the acknowledgment counterfoil with my return ?

No, it will be considered sufficient proof if you quote your Challan Identification Number (CIN) as mentioned in your counterfoil in your return.

12. **What is the timing for making payment through internet ?**

    You will have to check the net-banking webpage of your bank's website for this information.

13. **If I encounter any problem while making payment through internet whom should I contact ?**

    If any problem encountered at the NSDL website while entering non-financial data then contact the TIN Call Center at 022-24994650 or write to us at e-tax@nsdl.co.in.

    If any problem encountered while entering the financial details at the net-banking webpage of your bank, then you should contact your bank for assistance.

14. **Where should I make enquiries about my tax payments through internet ?**

    You should contact your bank for queries about your payment transaction through internet.

15. **Whom should I contact if the counterfoil containing the CIN is not displayed on completion of the transaction and if I want duplicate counterfoil ?**

    Your Bank provides facility for re-generation of electronic challan counterfoil kindly check the Bank website, if not then you should contact your bank request them for duplicate challan counterfoil.

16. **If I have misplaced my counterfoil whom do I contact ?**

    Your Bank provides facility for re-generation of electronic challan counterfoil kindly check the Bank website; if not then you should contact your bank and request them for duplicate challan counterfoil.

17. **After making e-payment of direct tax if status of challan is not available under Challan Status Enquiry on NSDL site, what should I do ?**

    You can verify the status of the challan in the "Challan Status Inquiry" at NSDL-TIN website after 5 to 7 days of making e-payment. In case of non availability of the challan status kindly contact your bank..

18. **If I encountered any error on NSDL site while making e-tax payment what should I do ?**

    If encountered any error on e-tax website kindly contact TIN call centre at 022-24994650 or write to us at e-tax@nsdl.co.in.

19. If after entering challan details in NSDL site if Bank Name is not being displayed what should I do ?

The problem may be encountered because of the following :

Reason 1 : If Assessee enters incorrect TAN / PAN in challan data entry screen.

Reason 2 : If Assessee using Internet Explorer browser then temporary internet files should be deleted by following :-

(A) Open Internet Explorer window.

(B) Go to "Tools" Menu.

(C) Select "Internet Options".

(D) Delete cookies and Delete temporary Internet files on your machine.

(E) Close the current Internet Explorer windows.

(F) Again go to tin-nsdl site & make e-payment.

If still above raised problem not resolved then kindly contact the TIN Call Center at 022-24994650 or write to us at e-tax@nsdl.co.in

20. Account get debited more than once for the same e-tax transaction what should I do ?

If during the transaction or after completing the transaction bank site encountered any error or get disconnected before generating Taxpayer counterfoil then instead of doing the same transaction again kindly check your Account, if account is being debited then contact your bank for regeneration of taxpayer counterfoil . Please note in the above case donot make the same transaction again which result in account debited more than once for same e-tax transaction.

21. How secure is the transmission of data to the website for e- payment ?

All transmission through NSDL-TIN website is encrypted and is with Secure Socket Layer (SSL) authentication. With respect to the banks, it depends on the security measures provided by the bank for net-banking.

22. How does this system of payment of taxes through internet benefit me as a taxpayer?

This system is beneficial to you as you are not required to personally visit the bank to make the payments. Payment can be made electronically at your convenience from any place where an internet facility is available e.g. your office, residence, etc. Further, you get the Challan Identification Number (CIN) online, which is required by you when you file your return.

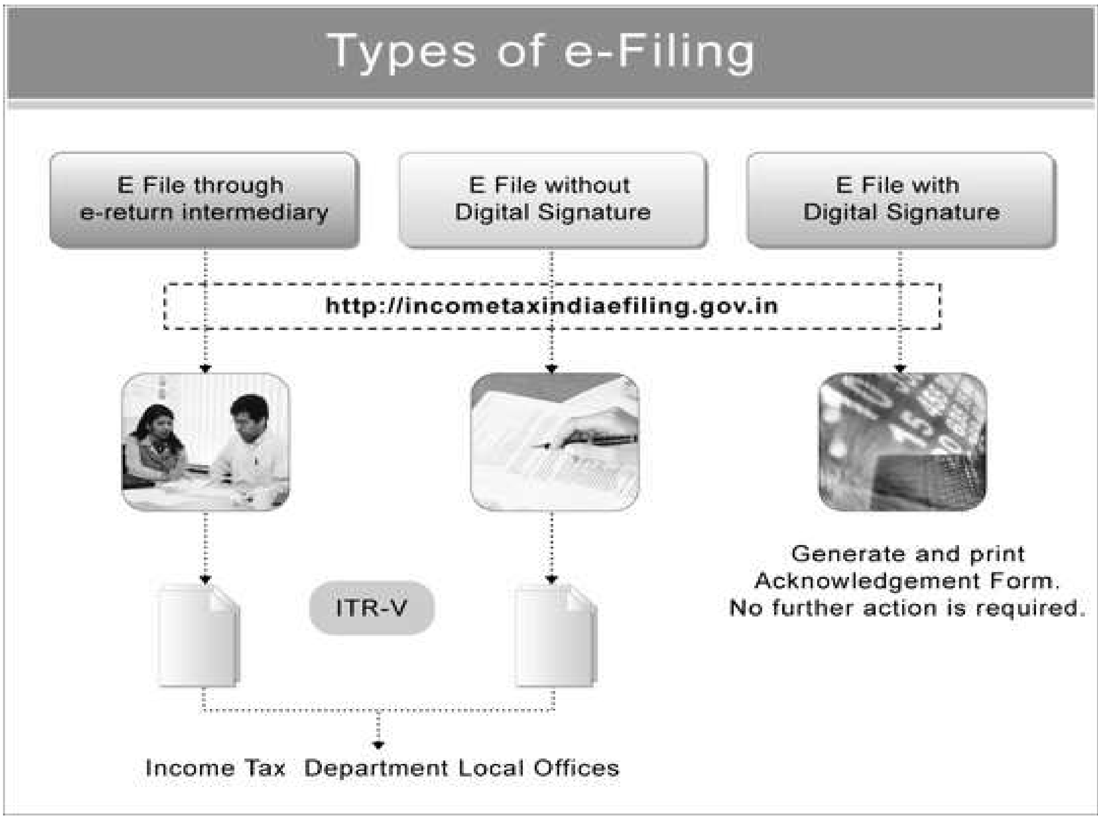
4.2.8 e-filing of Income Tax Returns

4.2.8.1 e-filing of return

- The process of electronically filing Income tax returns through the internet is known as e-filing.
- It is mandatory for companies and Firms requiring statutory audit u/s 44AB to submit the Income tax returns electronically.
- E-filing is possible with or without digital signature.

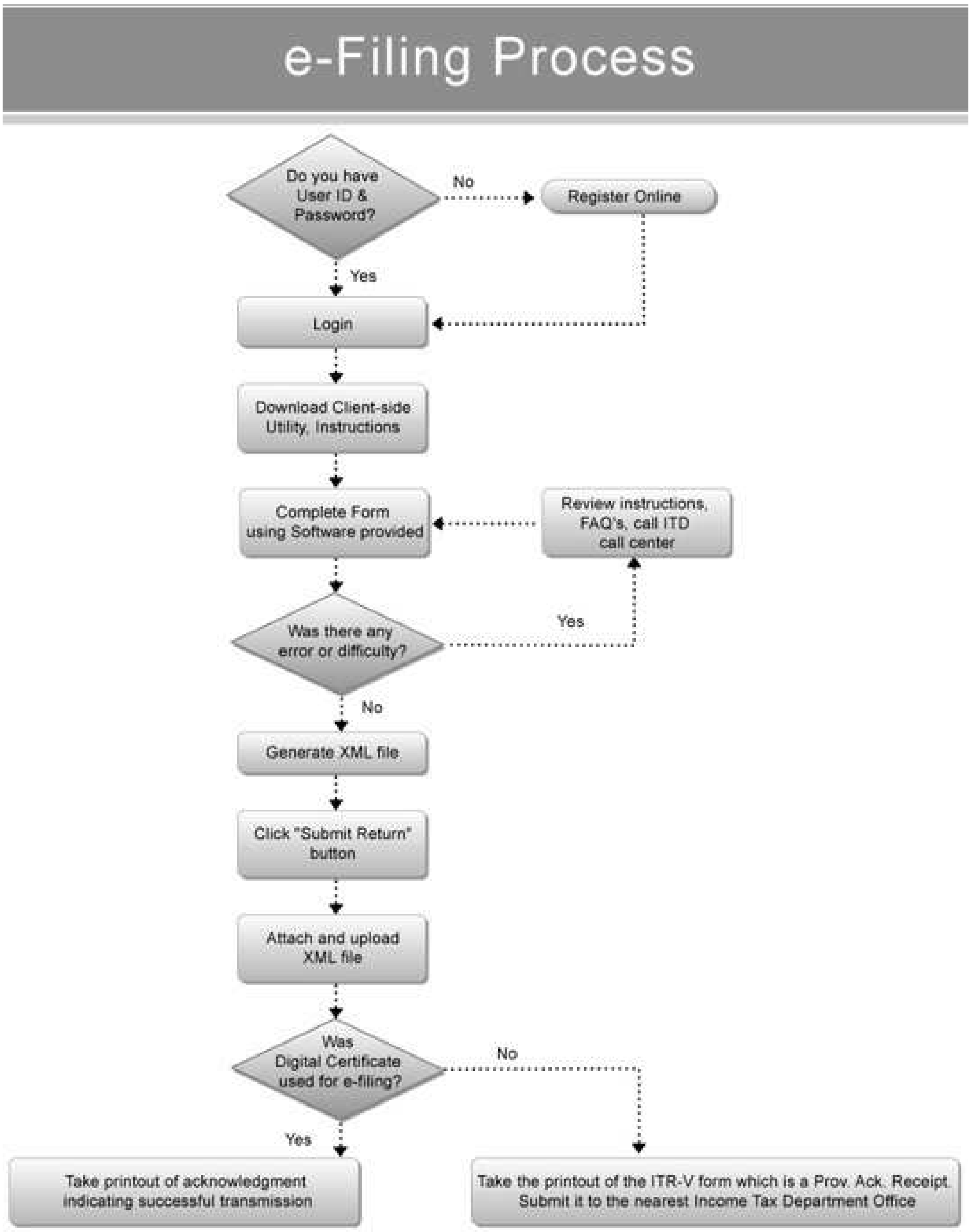
4.2.8.2 Types of E-Filing…

- There are three ways to file returns electronically.
- **Option 1 :** Use digital signature, in which case no further action is required.
- **Option 2 :** File without digital signature, in which case ITR-V form is to be filed with the department. This is a single page receipt cum verification form.
- **Option 3 :** File through an e-return intermediary who would do eFiling and also assist the Assessee file the ITR -V Form.



4.2.8.3 e – filing process

This is explained below with the help of a flow chart.



4.2.8.4 Change in the procedure of e- filing from 2008-09

Type	Change
For digitally signed returns	No Change
Paper Returns -Two step Procedure	After uploading data -instead of filing paper return assessee to file verification form called ITR-V
Paper Returns - through e-intermediaries	(Combination of Acknowledgement of e-return and verification.

4.2.8.5 Applicable Forms

For Individuals, HUF

Sr. No.	For ⇒	Individual	Individual, HUF		
	Source of Income ⇓	**ITR-1**	**ITR-2**	**ITR-3**	**ITR-4**
1	Income from Salary/Pension	•	•	•	•
2	Income from Other Sources (only Interest Income or Family Pension)	•	•	•	•
3	Income/Loss from Other Sources		•	•	•
4	Income/Loss from House Property		•	•	•
5	Capital Gains/Loss on sale of investments/property		•	•	•
6	Partner in a Partnership Firm			•	•
7	Income from Proprietary Business/Profession				•

For Firms, Associations of Persons (AOP), Body of Individuals (BOI), Local Authority, Companies, Trusts, Fringe Benefit Tax (FBT) Return

Sr. No.	For ⇒	Firms, AOP, BOI Local Authority	Compa-nies	Trusts	Only FBT
	Source of Income ⇓	**ITR-5**	**ITR-6**	**ITR-7** # See Note	**ITR-8**
1.	Income / Loss from Other Sources	•	•	•	
2.	Income / Loss from House Property	•	•	•	
3.	Capital Gains / Loss on sale of Investments / Property	•	•	•	
4.	Income/Loss from Business	•	•	•	
5.	Fringe Benefit Tax	•	•	•	•

 # Note : ITR-7 will not be available for e-Filing.

Download Return Preparation Software.

4.2.8.6 Summary of e-filling process:

Procedure of e-Filing Process includes-

- Select appropriate type of Return Form .
- Download Return Preparation Software for selected Return Form.
- Fill your return offline and generate a XML file.
- Register and create a user id/password .
- Login and click on relevant form on left panel and select “Submit Return”.
- Browse to select XML file and click on “Upload” button .

- On successful upload acknowledgement details would be displayed. Click on “Print” to generate printout of acknowledgement/ITR-V Form.
- In case the return is digitally signed, on generation of “Acknowledgement” the Return Filing process gets completed. Assessee may take a printout of the Acknowledgement for his record.

  In case the return is not digitally signed, on successful uploading of e-Return, the ITR-V Form would be generated which needs to be printed by the tax payers. This is an acknowledgement cum verification form. The tax payer has to fill-up the verification part and verify the same. A duly verified ITR-V form should be submitted with the local Income Tax Office within 15 days of filing electronically. This completes the Return filing process for non-digitally signed Returns.

4.2.8.7 Exercise (For check your progress)

Q. 1 : What is e-Filing of Returns ?

Answer : Filing of Income Tax returns is a legal obligation of every person whose total income for the previous year has exceeded the maximum amount that is not chargeable for income tax under the provisions of the I.T Act, 1961. Income Tax Department has introduced a convenient way to file these returns online using the Internet. The process of electronically filing your Income tax returns through the Internet is known as e-filing of returns.

Q. 2 : How is e-Filing different from the regular filing of returns ?

Answer : E- filing offers convenience of time and place to tax payers. This facility is available round the clock and returns could be filed from any place in the world . It also eliminates/ reduces interface between assessee and tax officials. The procedure of e- filing is explained on the home page of the website

Q. 3 : Who can file returns On-line ?

Answer : Any individual or organization that files returns using the general method can take advantage of this facility. The pre-requisite for filing online is that you must have a valid PAN number. Direct E-filing is available for FORM NOs. **ITR-1, ITR-2, ITR-3, ITR-4, ITR-5, ITR-6 & ITR-8.**

Q. 4 : Can I use the same PAN for regular filing returns and E-Filing returns ?

Answer : Yes.

Q. 5 : What are the steps in brief to upload the tax returns on this website?

Answer : Select appropriate type of Return Form.

- Fill your return offline and generate a XML file.
- Register and create a user id/password .
- Login and click on relevant form on left panel and select "Submit Return".
- Browse to select XML file and click on "Upload" button .
- On successful upload acknowledgement details would be displayed. Click on "Print" to generate printout of acknowledgement/ITR-V Form.
- In case the return is digitally signed, on generation of "Acknowledgement" the Return Filing process gets completed. Assessee may take a printout of the Acknowledgement for his record.

In case the return is not digitally signed, on successful uploading of e-Return, the ITR-V Form would be generated which needs to be printed by the tax payers. This is an acknowledgement cum verification form. The tax payer has to fill-up the verification part and verify the same. A duly verified ITR-V form should be submitted with the local Income Tax Office withing 15 days of filing electronically. This completes the Return filing process for non-digitally signed Returns.

QUESTIONS RELATED TO FORMS

Q. 1 : Whether the address given in the PAN card is to be quoted or the current address which may be different from the PAN card address can also be quoted ?

Answer : The assessee has to quote the current address on the returns forms.

Q. 2 : Which form of return would be applicable to the persons who are carrying on proprietorship business and also partnership business ?

Answer : The relevant form would be ITR-4.

Q. 3 : In ITR-4, there is no separate requirement for mentioning the trade name of the proprietary firm; disclosure of trade name is essential as most of the proprietors carry their businesses in the proprietorships firm name only.

Answer : Under the heading "Nature of Business" in "Part A General", column has been provided to disclose the trade name of the proprietorship.

Q. 4 : If an individual has loss from house property, can he use ITR-1?

Answer : No, he has to use form no. ITR-2.

Q. 5 : What is purpose and implication of ITR-V?

Answer : This is to simplify the filing of return electronically without digital signature. Last year, the taxpayer was required to take a printout of e- return and submit it in the Income Tax office after verification. To further simplify this procedure ITR-V form has been introduced. This is a single page acknowledgement cum verification form. The assessee has to put his signature and submit it in I.T.office. The requirement of submitting a copy of the return has been dispensed with.

Q. 6 : What form of return should be filled by a salaried class person having housing loan also?

Answer : ITR-2

Q. 7 : In case filing is done online with digital signatures, no stamped acknowledgement would be available. This would create problems for the assessee for obtaining visa, loan etc. Is there any system to verify online whether IT returns of a particular year has been filed

Answer : We would be offering this facility shortly through web. The assessee would be able to view this under the head 'MY ACCOUNT'.

Q. 8 : What would be the status of a person who is having more than one type of businesses? He would have to prepare a consolidated balance sheet and profit and loss, to quote figures in the new forms. This would unnecessarily increase the workload of the assessee who already has to prepare the financial statements in different format for different purposes i.e MCA-21,VAT return , bank loan purposes etc.

Answer : Every person carrying on the business or profession has to prepare a consolidated balance sheet and profit and loss account. This is a legal requirement under income tax act. The assessee may minimize his efforts by choosing to file the return electronically.

Q. 9 : ITR-4 requires the assessee to mention the amounts debited to profit and loss account to the extent disallowable under section 40A(2)(b). Under this section the amount is disallowed only if the payment made is excessive in the opinion of the assessing officer. Now the question arises as to how can the assessee step into the shoes of the assessing officer and fill this information.

Answer : The assessee may provide the figures as per his understanding.

Q. 10 : Are the details required under Annual Information Report mandatory to be filled in by all assessee ?

Answer : As provided in the Instructions for filling the forms that these are applicable who fulfill the criterion.

Q. 11 : Which return form has to be used by a person who has only exempt share income from a firm ?

Answer : FORM NO. ITR-3. For the assistance of taxpayer, functionality is in the web site to select the appropriate type of form.

Q. 12 : If an individual has loss from house property, can he use ITR-1 ?

Answer : No.

Q. 13 : If AOP/BOI do not have taxable income, can they use ITR-8 instead of ITR-5? What about a firm? Can they also use ITR-8 instead of ITR-5 ?

Answer : If they are not required to file return of income tax.

Q. 14 : Is it necessary to file these returns in duplicate for getting acknowledgement?

Answer : As explained above , if it is filed electronically without digital signature, only ITR- V form is to be submitted. If the return is filed with digital signature, nothing needs to be submitted , not even form ITR-V.

Q. 15 : ITR-1 is return for individual having income from salary/pension/ family pension and interest. An individual having only salary income and no interest income may use this form or he has to go for ITR-2 ?

Answer : He may use ITR-1 form.

Q. 16 : ITR-2, 3 and 4 require detailed breakup of salary income like exempt allowances; perquisites etc, whereas ITR –1 requires only a single figure for salary. Is there any specific reason for such differential treatment ?

Answer : This is for the convenience of small taxpayer.

Q. 17 : A person is proprietor of two different proprietary concerns having different business each having turnover more than 40 lacs and audited u/s 44AB by different chartered accountants which data he has to fill in form no.ITR 4, as the space provided for the profit & loss account and balance sheet is for only one proprietary concern. It is suggested that the separate sheet to be allowed to be inserted in the same format for the each proprietary concern.

Answer : The taxpayer has to provide consolidated balance sheet / profit and loss account.

Q. 18 : If a person wants to file the personal balance sheet where can he do so.

Answer : It is not required under the Act. In ITR – 4, the Assessee has to give the of his proprietory business and not of his personal assets and liabilities.

Q. 19 : What is to be filled in part A – QD that is the quantitative details if the persons is under tax audit and not having quantitative details of the goods as he is in a business which is comprising of thousands of small commodities where none of the commodity is having a turnover of more than 10% of the total turnover e.g. Grocery shop, Hardware & Paint dealer, Stationery Shop, other retailers.

Answer : He may not fill these columns.

Q. 20 : The assessee who is under presumptive taxation scheme i. e. "no accounts case", what he should write for sundry debtors, sundry creditors, stock in trade, cash balance, gross profit as he may not have all these details since he is not maintaining books of accounts.

Answer : He has to give these figures from primary records.

Q. 21 : If a persons is receiving as a partner interest, remuneration from a firm and is also proprietor of a concern can he show the share of interest and remuneration received from n schedule BP (computation of income for Business or Profession) in item no. 23 as any other income not included in profit and loss account or in item no. 22 any other item or items of addition under section 28 to 44DA.

Answer : Yes.

Q. 22 : How the income from house property is to be shown if the property is partly self occupied and partly rented.

Answer : It is to be shown on proportionate basis.

Q. 23 : Income from self occupied property has loss after deduction of interest on borrowing in which column should if be mentioned.

Answer : It should be mentioned in schedule in HP and set off up of the loss from the current years income should be carried out in schedule CYLA.

Q. 24 : Many professionals have only one savings account and all professional income is in the same account. For him there may not be any balance sheet of his business. What should he fill up in the Balance Sheet part ?

Answer : This is a legal requirement. One has to fill up the details in the balance sheet which may be worked out from the bank account or from other records maintained by the Assessee.

Q. 25 : The profit and loss account contained in the forms require the assessee to furnish complete details of different types of duties paid or payable in respect of goods and services purchased. In majority of cases this may not be practically possible.

Answer : It is provided in the instructions that in such situations one can show the purchases inclusive of duties and taxes.

Q. 26 : The structure of the profit and loss account is such that it suits manufacturing or trading business only. It does not suit the service providers like hotel, transport agents, professionals etc. It is likely that the assessees in the service industry will have to recast or reframe its profit and loss account. Please clarify as to how service sector requirements could be factored in.

Answer : The balance sheet and profit and loss account are trade independent. These are the part of accounting systems. One has to follow these system which are standardized. Some amount of re-casting/re-framing may be required.

Q. 27 : Are the details required under Annual Information Report mandatorily to be filled in by all assessee ?

Answer : This is mandatory requirement for those to whom it is applicable. Please read instructions given with the return in this regard.

Q. 28 : Can the stand-alone form on Fringe Benefits be used by companies and firms as well ?

Answer : Form no. 8 is only for those assessees who are not supposed to file I.T. ve to file return of FBT.

Q. 29 : If AOP/BOI do not have taxable income, can they use ITR-8 instead of ITR-5? What about a firm? Can they also use ITR-8 instead of ITR-5 ?

Answer : It is the requirement of filing the return of income which would decide the issue and not the amount of taxable income. ITR-8 is to be used if the taxpayer is not required by the law to file income tax return but has FBT liability.

Q. 30 : What form of return should be filled by a salaried class person having housing loan also ?

Answer : Form no. ITR-2.

Q. 31 : As the returns now are annexure less, it is difficult to comprehend as to how the Assessing Officer is going to verify the veracity of various claims made in respect of investments not reflected in Form 16.

Answer : At the processing stage no verification is required under the Act. The cases which are picked up under scrutiny could be verified during scrutiny proceedings.

Q. 32 : As per Section 50 the Income-tax Act, there is no need to disclose sale of fixed assets made during the year out of purchases for a period of 180 days or more, or purchases for a period less than 180 days. The details asked in the Schedule DPM are against the provisions of Section 50?. Please clarify the same.

Answer : The form has been designed keeping in view the provision in the Act. The interpretation given above is not borne out by the Act. The details in schedule DPM are in conformity with section 50.

Q. 33 : Individuals/HUF who are self employed doing brokerage, commission, CA practice, doctors, architects, beauty parlour, etc. and does not maintain their accounts related to the business but maintains personal accounts in the form of profit & loss and balance sheet.Please let me know: Which ITR form to be used. If ITR 4 is to be used whether the personal accounts to be treated as accounts of proprietory business and accordingly to be loaded in the form.

Answer : ITR-4 would be the applicable form. Personal accounts or assets/ liabilities are not required to be shown. Only business assets/ liabilities are to be mentioned.

Q. 34 : In case of salaries how to incorporate details of more than one employer.

Answer : In the software facility exists to use dynamic rows to take care of more than one employer.

Q. 35 : Whether all types of pension viz. under Superannuation scheme, Family pension Fund, Employees pension Scheme, pension from LIC under Jeevan Suraksha etc is to be shown under the head “Salary” or all/any of the above is to be shown under the head “Income from other sources”.

Answer : NO, this has to be shown as income from other sources.

Q. 36 : A partnership firm engaged in retail trade declares net profit @ 5% of gross turnover. As such it is not required to maintain books of accounts. It pays salary and interest to its partner in accordance with law. Consequently its net profit as well as taxable income is reduced to nil. How can the above be filled up in ITR 5 so as to reflect that the profit declared complies with the provisions of section 44AF and also the computational provisions of the I.T. Act ?

Answer : If the assessee does not maintain books of accounts , he has to fill in column no. 52 of Part A- P&L. The business profit is to shown as per column 52d of schedule P&L. It is provided in schedule BP also in the same manner.

Q. 37 : In ITR– 4 the requirement relating to statutory reserves in case of individual or HUFs carrying on proprietorship business or profession does not appear to be in place.

Answer : It is provided in Part A-BS 1 (b) iii.

Q. 38 : ITR form no. 8, why tax auditor details are required when income tax return is not required to be filed.

Answer : The audit is a mandatory requirement of the law. What has been relaxed is only its non submission at the time of filing of return. Therefore, the details are required as a check against misuse.

Q. 39 : The proprietor is having personal set of books in addition to business books. How to accommodate two balance sheet in ITR-4.

Answer : Personal balance sheet is not called for in the return. Only business details are required.

Q. 40 : An assessee earns income from Salary + Interest + Dividend. Dividend is exempt u/s 10. Which form to be used ? Form 1 or Form 2 ?

Answer : Form no ITR-2. Exemption of income is not the criterion.

Q. 41 : In schedule of AIR of all ITRs relating to financial transactions whether the limit fixed is for aggregate or single in each category as shown in the following transactions.(a) saving account with more than on Bank. (b) credit card with more than one Bank. (c) purchase of units of mutual funds. (d) bonds or debenture of more than one company or institution. (e) equity shares issued by more than one company. (f) purchase or sale of more than one property.

Answer : This limit is the aggregate value for all transactions except property value where it is the value of a single transaction.

QUESTIONS RELATED TO E-FILING PROCESS

Q. 1 : I don't understand the process of E-Filing. What should I do?

Answer : To understand the procedure to file e-returns, use the Help file, available on Home page of the web portal, which can be accessed by clicking the link "How to e-File" to know more about e-returns.

Q. 2 : I have no clue about computers or software. What should I do?

Answer : To understand the procedure to file e-returns, use the Help file which can be accessed by clicking the link Click here to know more about e-returns.You need access to a computer which can be connected to the Internet via a dial-up, leased line, broadband or any other means. Then, you must open an Internet Browser in the computer, type in http://incometaxindiaefiling.gov.in and press the Enter Key on the computer's keyboard.

Q. 3 : Why do I need to Register ?

Answer : You will need to register in order to e-file your income tax returns. To do this, a unique user ID is required which can be obtained only by registering on this website.

Q. 4 : What information do I need to register online?

Answer : The basic information requires is: PAN, Full Name, DOB, Postal Address, E-Mail ID and Phone Number.

Q. 5 : If a person forgets his password of login id then what can he do ? Is there any procedure to retain the password again?

Answer : It is advised that users retain their passwords securely. Click on the link "Forgot Password" and enter the mandatory fields along with your userid. If the information provided matches correctly the user will be allowed to select a new password.

Q. 6 : REGISTRATION:Should Registration be made in the name of the Company or Can a director register in his name and file the returns of the company ?

Answer : No, a company has to create its own userid and password using its PAN. The company return can be only filed under that userid / password since the PAN in the return must match that of the PAN associated with the userid / password.

Q. 7 : Can a Chartered Accountant file on behalf of the Company ? If a person is C.A and he wants to file the return of different companies, is it necessary to make a separate user id and password of all the companies or can he file the returns of different companies with his login only ?

Answer : No, unless the Chartered Accountant is a duly registered e-Return intermediary he cannot file on behalf of the company. A company has to create its own userid and password using its PAN. The company return can be only filed under that userid / password since the PAN in the return must match that of the PAN associated with the userid / password. The userid /password of the Chartered Accountant are linked to his individual or firm's PAN and therefore cannot be used.

Q. 8 : Certain Companies cannot be registered in the portal since the Company database is not up to date. In such cases, the Company cannot file their e-returns at all.

Answer : Please use exactly the same name as it appears in the PAN card or PAN intimation letter to avoid error in registration. If the name does not match exactly then Error message "Name entered does not match our records" will appear. The company database is continuously updated.

Q. 9 : Display of the entire master data of Companies is suggested to enable the companies to get registered easily and also rectify/update the master data.

Answer : It is not possible.

Q. 10 : As the data relating to PAN (Income tax website) & Incorporation date (MCA web site) are available over the Internet, any body could register in the name of the Company and falsify the IT returns. Accordingly additional security measures are suggested.

Answer : To register the name of the company,it must be exactly the same as it appears in the PAN card or PAN intimation letter. Additionally, the Company can file using its digital signature. In any other case the paper return with signature is required and shall be verified against the electronic return to ensure integrity of data.

Q. 11 : What happens if I Don't Register ?

Answer : Without the unique User ID and password, no individual will be able to access the web site. This registration needs to be done only once.

Q. 12 : What do I do next after registration ?

Answer : After registration, login into the Home Page of the INCOME TAX DEPARTMENT website using the newly generated User ID and password. For more details on the procedure to file ereturns, use the Help file by clicking the link Click here to know more about e-returns. Read the content on the website and access relevant Help Files to e-enable you to file the returns.

Q. 13 : What is the Return Preparation Software ?

Answer : The E-Filing Website has provided few User Friendly tools available for Free Download, these may be used by the individuals or organizations to file their returns electronically. These tools are called the 'Return Preparation Software'. To e-file your returns, you may download these Tools from the official E-Filing website and start the E-Filing process. You may choose any utility which you feel comfortable.

Please note that the input to the "Return Preparation Software" will be the actual data that you fill feed in. The output of this utility will be an XML file. This is the file that must be uploaded to the e-Filing website.

Q. 14 : Is it necessary that I use the Client Side Utility created by Income tax Department ? Can I use some other utility ?

Answer : The e-Return Return Preparation Software provided at the Income Tax Department website are free for anyone to use in order to create the e-return XML file. End users are also free to use any other utility created by other software providers, as long as the XML output conforms to the XML Schema which has been posted at the E-Filing website. However, these other software utilities available in the market may require payment for usage.

Q. 15 : What are the system requirements to download and use the Client Side Utility ?

Answer : The minimum system requirements needed to download and use the Return Preparation Software are PC with 128 MB Ram, PIII processor or equivalent, at least 25 MB free hard disk space, internet connection, Internet Explorer (version 5 or higher) and Windows Operating system (Win 2000 or higher version) and Adobe Acrobat Reader 8.1.0.

Q. 16 : What are the system requirements for viewing the website ?

Answer : The website is a Java based. JRE (Java Run-time Environment Version1.6 (called JRE 6 (Beta)) may be required to be installed on the computer. Java is freely downloadable from http://java.sun.com/ and http://www.ibm.com/developerworks/java/jdk or you can ask your vendor providing computer facilities (hardware) to install the same for you. However, most PCs using Internet Explorer (version 5.5 or higher) would already be having Java or JRE (Java Run-time Environment) and there should not be any problem in viewing the site.

Q. 17 : Where do I save the downloaded files ? Can I delete them later ?

Answer : You can download the files on to your local machine. Fill in the required information and upload the file back on to the web site. After receiving an acknowledgement of the submission, the file can be saved.It is recommended that the XML file be retained for your records. It is recommended that a print out of the form be taken and the information duly filled records.

Q. 18 : What is XML ?

Answer : XML stands for Extensible Markup Language. It is a general purpose markup language designed especially for Web documents. XML is a way of describing data and it allows designers to create their own customized tags, enabling the definition, transmission, validation, and interpretation of data between applications and between organizations. Any Client Side Utility which creates an e-return XML will be a file with an extention .xml. This is the file that must be uploaded to the E-Filing website.

Q. 19 : What is a Schema ?

Answer : A schema refers to the collection of database objects associated with a particular database. Any user who files e-return will have created an xml file based on the schema. A simple analogy would be that the schema represents a letter template where the user enters the addressee details, name, salutation, body text etc which then completes the document which is the equivalent of an xml file. The template ensures uniformity and standardization of the format of the letter in the same way that the schema provides a structure to the xml file.

On uploading the file on to the system, a unique database object is created in the Income tax Department system. If you are using the services of the Utilities available at the e- Filing website, or any other Utility capable of generating an e-return XML for these forms, you need not download the schema or be worried about it. The Schema is made available to those individuals, software companies and organizations who wish to use this code to help create their own software utility for filling up these forms.

Q. 20 : Can the schema be changed? What is the impact of any change in the schema?

Answer : Only the new schema should be used while creating the xml file. However, the changes do not in any way impact the returns already filed through the website, which continue to be valid. However, returns that would be filed henceforth will need to conform to the new schema.

Q. 21 : What does Uploading mean? How can a person upload his return on website and in which format?

Answer : The XML file format of the return prepared using software utilities has to be submitted to the Income tax Department E-Filing website so that it can be processed for the e-returns. This process is referred to as uploading.

Q. 22 : How do I get a confirmation that my tax return has been filed successfully?

Answer : After the e-return file has been uploaded successfully onto the Income tax Department server, a receipt is displayed with an acknowledgment number. The acknowledgment number is confirmation of the successful submission of your e-returns.

Q. 23 : How should I get a acknowledgement number?

Answer : The receipt containing the acknowledgement number is the only valid proof of electronic submission of the return. A physical return without a provisional acknowledgement number cannot be accepted for further processing and would be returned.

Q. 24 : E-Filing STATUS: Other than the online acknowledgement, the assessee does not have any facility to check the status of the uploaded e-return. There may be situations, when the assessee may have uploaded but the department may not have received the return. Accordingly, it is suggested that the portal display the status of the filed e-return (similar to refund status) to assure the assessee of the completeness of the transaction.

Answer : The assessee would be able to printout acknowledgement with an acknowledgement / ITR-V form in case of a successful upload. In case of any breakdown during the transmission of the xml file, the assessee can re-submit the return. However, the assessee can verify the "My Return" submenu under the "My Account" menu. If the return had been uploaded successfully before the breakdown in transmission, the copy of the acknowledgement will be available for taking printout. The acknowledgement sheet can also be reprinted under "My Return" submenu after logging in.

Q. 25 : Why do I get an error message at the time of submission ?

Answer : It could generally happen due to incorrect data or non-filling of mandatory fields. Rectify the errors until there are no further error messages. Please do not use any Special Characters such as **-, _, &, !, ^, <, >, #, ~, %, or *** while doing data entry since it may cause an error while generating XML file or while uploading the XML file. In case the problem persists contact the call center or report the problem in the website.

Q. 26 : VERACITY OF RETURNS: The IT department cannot verify the veracity of the returns since there are no accompanying documents. Further, since audit reports are not annexed, there is a risk that assessees may upload their unaudited statements upfront and obtain the tax audit reports only when called for during scrutiny. It is suggested that the assessees upload their enclosures in a suitable format along with the returns to enable assessment.

Answer : The question of disclosure would arise at the time of scrutiny assessment only. The assessee can disclose matters provided in the return u/s 143 (2) of the IT Act, if the case is selected for scrutiny. At the time of processing, no penalty is leviable and there is no necessity of any disclosure. The paper return and the electronic return would be matched to ensure data integrity. The assessee has to either attach a digital signature or file the paper return with the signature and verification. Any false declaration would invite relevant proceedings under the Income Tax Act.

Q. 27 : MISCELLANEOUS: There is lack of awareness among the public regarding the web portal for E-Filing. Further, the site www.incometaxindia.gov.in does not carry any link to the E-Filing portal.

Answer : Awareness is being increased through a series of advertisements. The http://www.incometaxindia.gov.in site has a link on the main page to the E-Filing website.

Q. 28 : The Procedure for E-Filing has not been prominently displayed in the web site. Taxpayers are still groping in the dark as to whether the returns have to be filed manually or electronically.

Answer : The Income Tax Department has provided detailed help document of the E-Filing process. Comprehensive Frequently Asked Questions list has also been provided.

Q. 29 : Other practical issues such as revised returns, resubmission of returns (in case of break in connectivity etc) need to be addressed adequately.

Answer : Revised returns have to filed in the same way as original returns. The Acknowledgement number of the Original return can be entered.

Q. 30 : Certain assessees have also expressed their apprehension in filing their sensitive IT details through third parties/intermediaries.

Answer : The assessees can directly upload their return to the Income Department website in case of any apprehension about sharing sensitive information.

Q. 31 : Can I talk to somebody who can help me understand the process of E-Filing?

Answer : Yes, you can contact our call center Aayakar Sampark Kendra (ASK) on phone number 0124-2438000 for assistance.

Q. 32 : Is there any time limit for submitting Form ITR-V (ITR Verification Form), when the return is filed electronically without digital signature, to the Income-tax Department?

Answer : Yes, verified ITR-V form is to be submitted in the Income Tax Office with in 15 days of e-filing.

Q. 33 : The minimum/exact configuration of computer required for e-filing may please be publicized / stated.

Answer : Minimum configuration of computer - (a)P-IV PC. (b)Windows 2000/XP or above. (c)RAM 512 MB. (d)Broadband Connection.

Q. 34 : What is a bar - coded return and how to file it?

Answer : This is a new initiative of the department. ITR-1 & ITR-2 forms could be submitted containing bar codes. Such returns could be read with the help of a scanner obviating the necessity of data entry work. This would expedite the processing of the return and thus better taxpayer service. One has to use the return preparation software provided on the web site to generate bar coded returns. The filing process is similar to that of a paper return.

Q. 35 : Within what period the verification of the return in form ITR-V is required to be submitted. Whether above form is required to be submitted to the jurisdictional assessing officer necessarily or it may be submitted to any income tax office in India in view of on line net working. The date of transmitting the data electronically or dispatch of ITR – V (by Fax/ Courier/ post) or receipt of above form by income tax office shall be considered for the purpose of considering the date of filling the return. What are the consequence of non filing /late filing / non receipt of form ITR – V by Income Tax Dept.

Answer : These issues have clarified by the Board in its Circular no. 5/2007 dated 26-07-2007. The ITR-V form is to be submitted with in 15 days of electronic transmission to the income tax department. If so, the date of e- filing shall be the date of filing of return. Else, the date of filing of return shall be taken to be date of submission of ITR-V FORM. Board has issued instructions to field formations to receive ITR-V forms centrally.

QUESTIONS RELATED TO DIGITAL SIGNATURE

Q. 1 : What is a Digital Signature?

Answer : A digital signature authenticates electronic documents in a similar manner a handwritten signature authenticates printed documents. This signature cannot be forged and it asserts that a named person wrote or otherwise agreed to the document to which the signature is attached. The recipient of a digitally signed message can verify that the message originated from the person whose signature is attached to the document and that the message has not been altered either intentionally or accidentally since it was signed. Also, the signer of a document cannot later disown it by claiming that the signature was forged. In other words, digital signatures enable the "authentication" and "non-repudiation" of digital messages, assuring the recipient of a digital message of both the identity of the sender and the integrity of the message.

A digital signature is issued by a Certification Authority (CA) and is signed with the CA's private key. A digital signature typically contains the: Owner's public key, the Owner's name, Expiration date of the public key, the Name of the issuer (the CA that issued the Digital ID), Serial number of the digital signature, and the digital signature of the issuer. Digital signatures deploy the Public Key Infrastructure (PKI) technology.

If you file electronically using digital signature you do not have to submit a physical copy of the return. Even if you do not have a digital signature, you can still e-File the returns. However, you must also physically submit the printed copy of the filled up Form along with the copy of the Provisional Acknowledgement Number of your e-Return

Q. 2 : How legal is a Digital signature?

Answer : India is one of the select band of nations that has the Digital Signature Legislation in place. This Act grants digital signatures that have been issued by a licensed Certifying Authority in India the same status as a physical signature. Digital signatures deploy the Public Key Infrastructure (PKI) technology.

Q. 3 : I don't have a Digital Signature. Does this mean I cannot file online?

Answer : In case you do not have a Digital Signature, you can still e-File the returns. However, you must also physically submit the printed copy of the filled up Form along with the copy of the Provisional Acknowledgement Number of your e-Return.

Q. 4 : Do I need a fresh digital signature in case I already have one?

Answer : A person/company who already has the specified Digital Signature for any other application can use the same for filings for the Income tax return and is not required to obtain a fresh Digital Signature.

Q. 5 : How much does a digital signature cost?

Answer : The Digital Signature certificates are typically issued with one year validity and two year validity. It includes the cost of medium (a UBS token which is a one time cost), the cost of issuance of Digital Signature and the renewal cost after the period of validity. The issuance costs in respect of each Certification Agency vary and are market driven.

Q. 6 : The Web site accepts Digital signature certificates in the formats: .pfx/ .p12. Other formats like .cer are not being accepted. Thus Persons who use USB tokens for securing their signature certificates are unable to use them for E-Filing.

Answer : Digital Signature Certificates in USB tokens are also accepted.

Q. 7 : It is not clear what class of Digital signature certificates should be used: Class 1/2/3

Answer : Digital Signature certificate should be of Class 2 or 3 only. It should also be ensured that the Digital certificate should be obtained only from among Certifying Authorities in India.

Q. 8 : It is also not clear as to whose Digital signature certificate should be used: Director (as in the case of MCA) / Company (as in the case of DGFT).

Answer : In case the electronic return is being signed digitally using a digital certificate, then the digital certificate should be that of the Authorized Signatory in accordance with the provisions of Section 140 of the IT Act. Therefore, for company returns, the digital certificate should be that of the Managing Director or the Director of the company.

QUESTIONS RELATED TO RETURN PREPARATION SOFTWARE

Q. 1 : There is no page to find out the AO Code details.

Answer : Click on 'My Jurisdiction' Submenu under 'My Account' menu after logging in to obtain jurisdiction details.

Q. 2 : Subsidiary Companies: There should be a separate provision for filling up data for overseas subsidiaries like overseas addresses etc. Currently, this page gives the option of selecting only Indian States and hence throws errors.

Answer : This has been corrected in new version of the Excel utility and the State code 99 can be used.

Q. 3 : Are details of tax payments as given in Schedules 19 to 23 required?

Answer : Yes, the details such as Challan Identification Number (BSR Code, Serial Number) etc required in Schedules 19 to 23, in case applicable, must be accurately and completely filled. If the details are incomplete or inaccurately credit for taxes may not be given and processing may get delayed.

Q. 4 : In case of refunds, the information desired is MICR, bank a/c number and type. The assessee is not required to mention the name of the bank. However, this may be necessary to ensure that the refund is not credited to a wrong account due to quoting of incorrect MICR code.

Answer : As per prevalent standard Banking practice. It is MICR code and the Bank er which uniquely determines the destination account. In case of wrong quoting of MICR code, the refund shall fail but would not be credited to the wrong account.

Q. 5 : MS- Excel format should also be provided for the convenience of the assessees.

Answer : For Form nos. 5 & 6, excel utility for preparation of return shall be provided.

Q. 6 : Can all ITR forms be filed electronically? What are the forms which can be filed physically?.

Answer : Yes.

Q. 7 : Is it mandatory for all firms to file return electronically?.

Answer : No. Only those Firms, who have to get their accounts audited under 44AB, are required to compulsorily file e- return.

Q. 8 : What are the ways in which return forms can be filed electronically?

Answer : This procedure is explained in detail at the web site. Please log on to http://incometaxindiaefiling.gov.in.

Q. 9 : MS- Excel format should also be provided for the convenience of the assessees.

Answer : ITR- 4, ITR-5, ITR-6 and ITR-8 would be in excel format.

Q. 10 : E-form cannot be saved in PDF format.

Answer : No such issue. As mentioned on the web site the taxpayer has to download Adobe 8.1.0 or above. This is a free download and can be downloaded from the various links provided on the home page of income tax portal.

4.3 Key Terms :

- **Service Tax -** Service Tax is a tax levied on notified services provided or to be provided in India, except in the State of Jammu and Kashmir.
- **VAT -** VAT is a Tax, which is charged on the increase in value of goods and services at each stage of production and circulation.
- **e-payment of taxes -** This is a facility provided to tax payers to make income tax payments through internet, using net-banking facility.
- **e-filing of returns -** The process of electronically filing income tax returns through the internet is known as e-filing.

4.4 Self Assessment Questions :

1) Objective Type: Chose the correct alternative:

i) Service Tax was introduced in India in the year:

a) 1991 b) 2000 c) 1994 d)2004

ii) Service tax was introduced first time on:

a) 3 services b) 6 services c) 4 services d) 5 services

iii) Service tax is a charge on:

a) Taxable service provided

b) Taxable service to be provided

c) Taxable service provided or to be provided

d) Any service provided or to be provided

iv) The provisions relating to valuation of taxable services are included:

a) In section 65 of the Finance Act, 1994

b) In section 67 of the Finance Act, 1994

c) In section 65A of the Finance Act,1994

d) None of the above

2) Short Answer Questions:

a. What is Service Tax?

b. How the value of taxable service is determined?

c. How the service tax is charged?

d. Who has to pay the service tax?

e. Explain the concept of VAT.

f. Give the difference between Sales Tax and VAT.

g. Give the list of services comes under Negative list.

h. Explain e-payment of taxes.

i. Explain e-filing of income tax returns.

4.5 Further Readings:

1. Dr. Ahuja Girish, Dr. Gupta Ravi: Systematic Approach to Income Tax, Service Tax and VAT, Bharat Law House Pvt. Ltd., New Delhi.

2. Manoharan T.N., Hari N.V.: Students Handbook on Income Tax, VAT and Service Tax, Snow White Pub., Mumbai.

3. Dr. Patil J.F., Dr. Patil V.S. (Ed.) : Service Tax, Shivaji University, Kolhapur.

4. Singhania, Vinod K. & Singhania, Monika: Taxmann Students Guide to Income Tax including Service Tax/VAT, Taxmann Publications, New Delhi

5. www.servicetax.gov.in

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